

# **Family Time, Cliffs, and Train Wrecks:** *Recalling California's State Budget*



**Daniel J.B. Mitchell**

*Global Association of Risk Professionals*

*Oct. 29, 2003*

# Where Have All The Flowers Gone?

Calypso tempo

P. SEGER



Where have all the flowers gone, long time pas - sing?



Where

go? —



Where

every-one.



When

? —





# Where Have All the Dollars Gone?



**Daniel J.B. Mitchell**



# Where Have All the Dollars Gone?



**Daniel J.B. Mitchell**





# Where Have All the Dollars Gone?



**Daniel J.B. Mitchell**



# Where Have All the Dollars Gone?



**Daniel J.B. Mitchell**



# Where Have All the Dollars Gone?



**Daniel J.B. Mitchell**



# Where Have All the Dollars Gone?

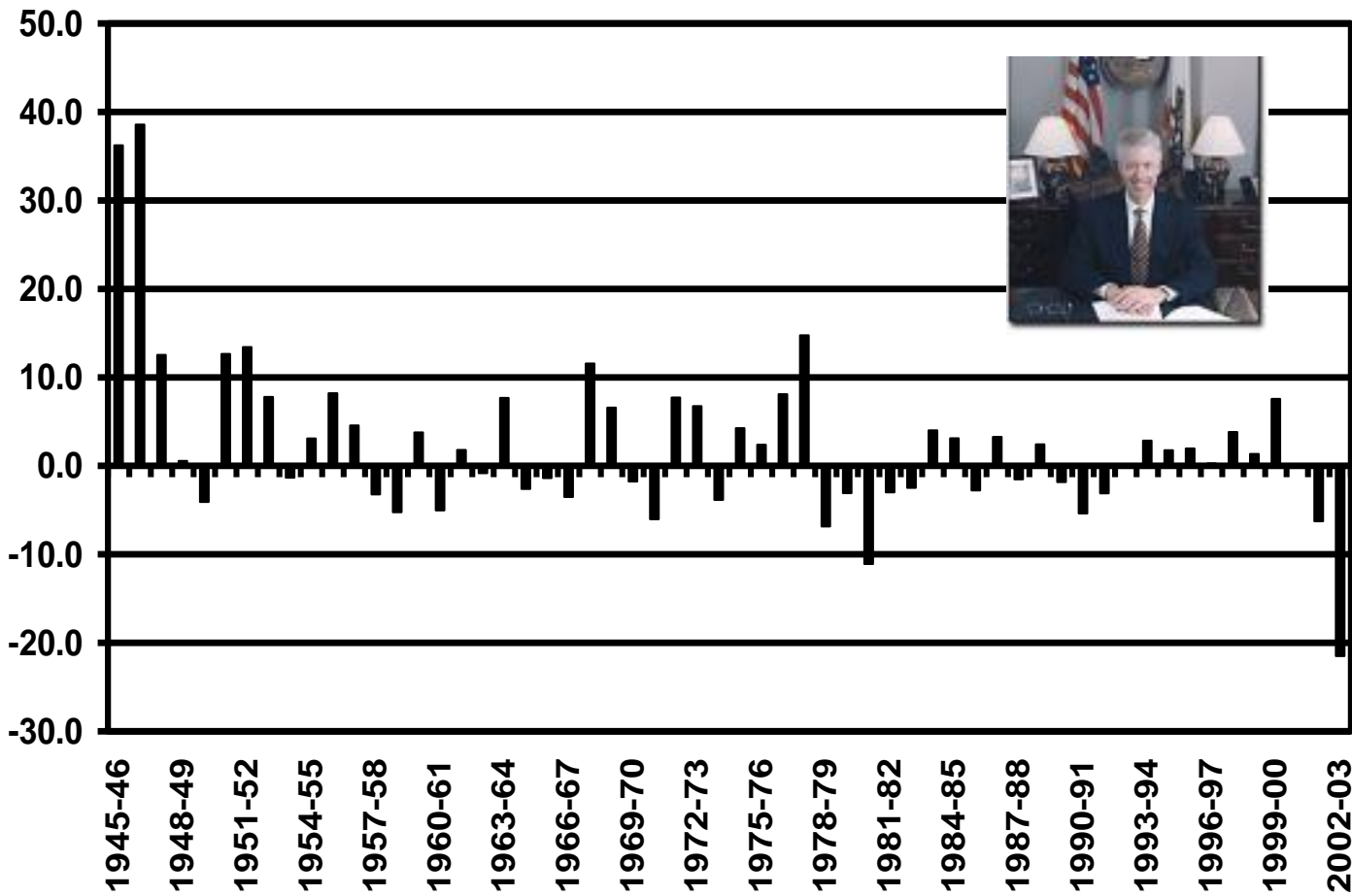


**Daniel J.B. Mitchell**

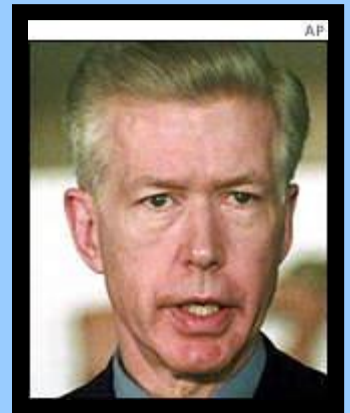


## General Fund Surplus or Deficit as Percent of Revenues & Transfers

CPObudget2004.xls  
Surplus%

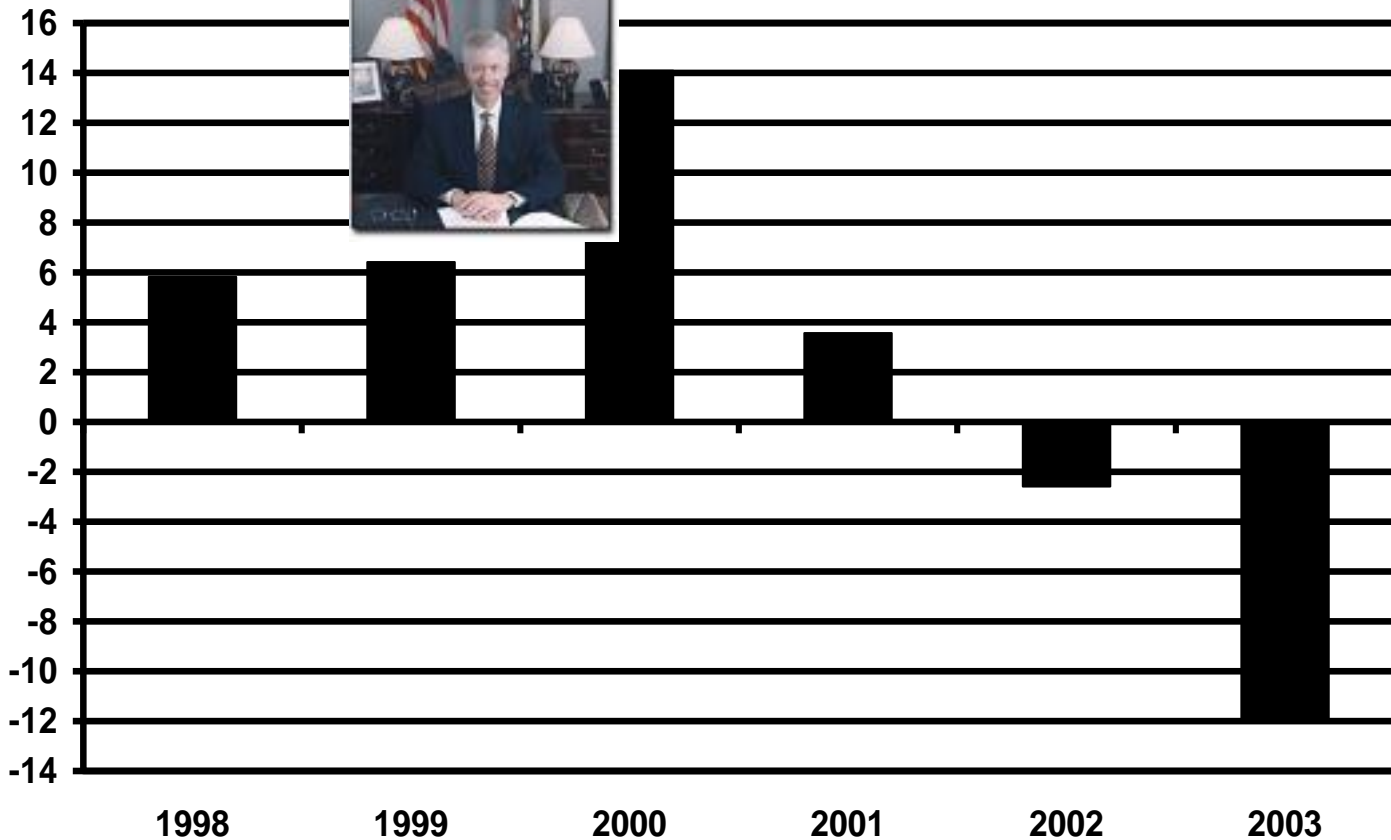


# What happened?



**Official Reserve as Percent of Expenditures: June 30 of Year Shown  
Excluding Proposed Deficit Finance for 2002-03**

CPObudget2004.xls  
offresrv

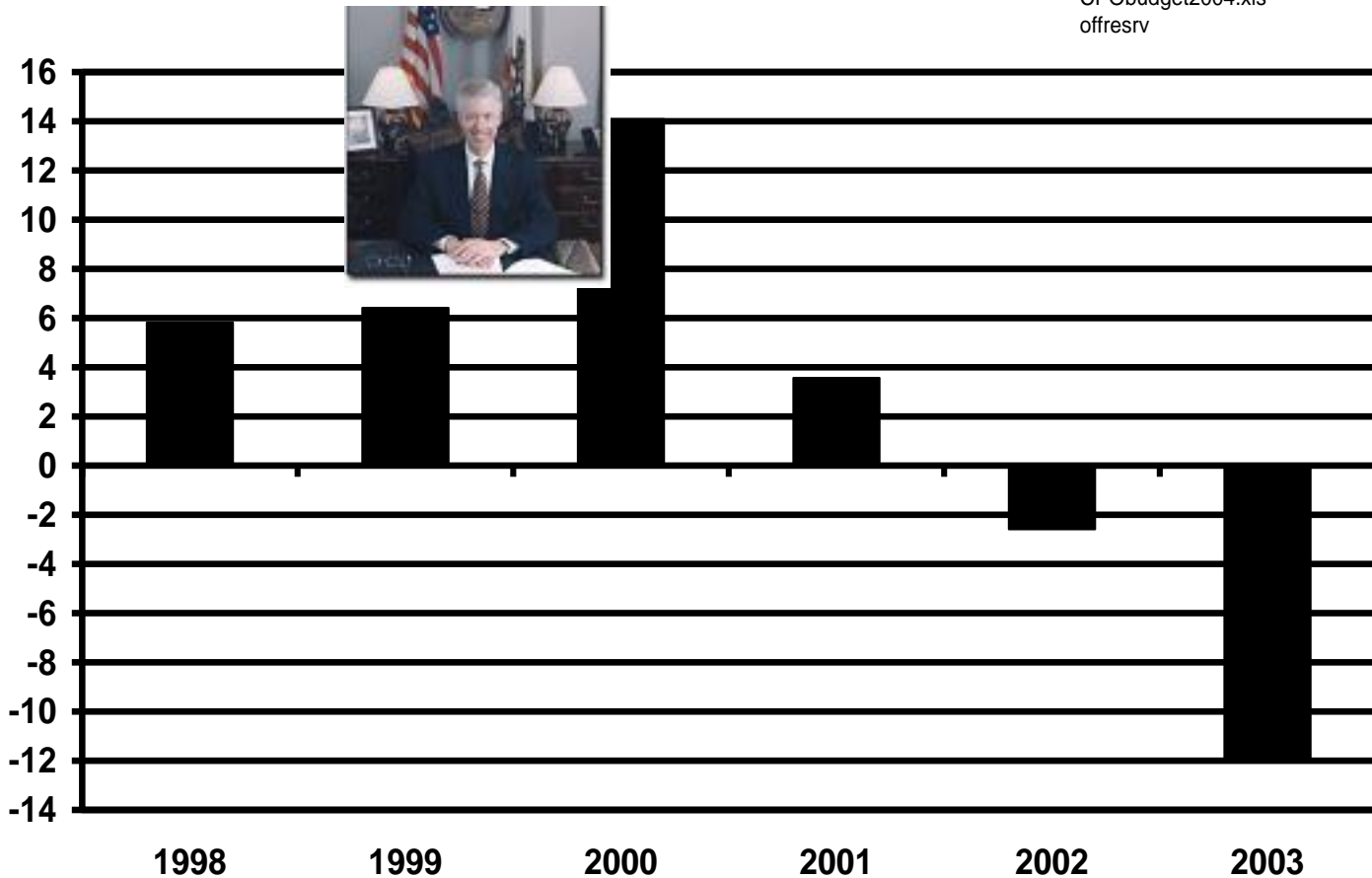


**What  
happened?**



**Official Reserve as Percent of Expenditures: June 30 of Year Shown  
Excluding Proposed Deficit Finance for 2002-03**

CPObudget2004.xls  
offresrv



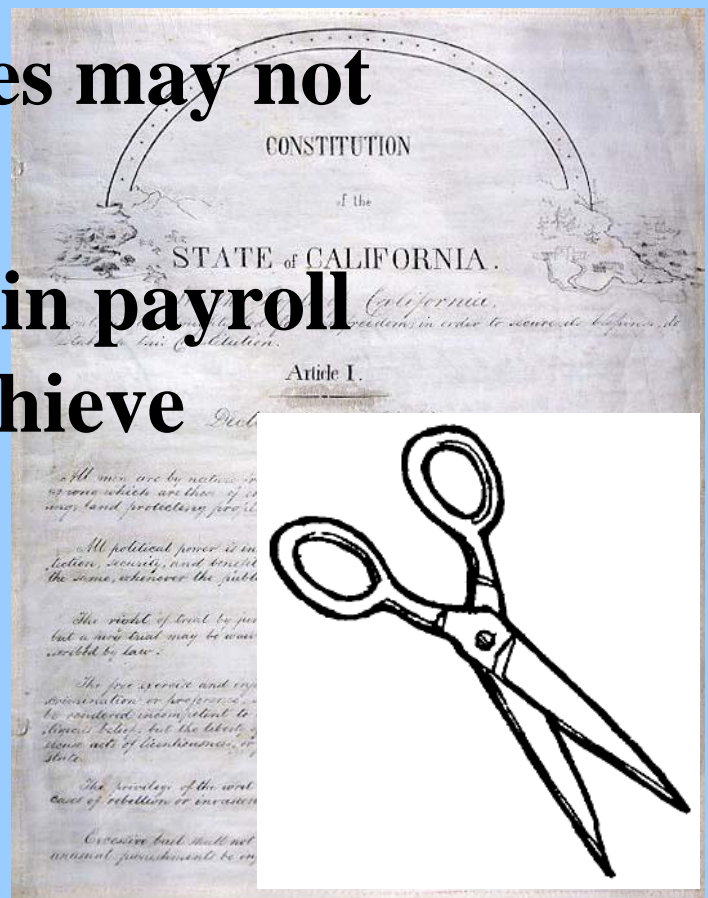
**What  
happened  
Hiram?**



# ***Risks in the current budget***



- Deficit financing may be illegal (\$2 + \$10.7 billion)
- RAWs mature in June 2004; high costs if must roll over
- Some revenues may not appear
- Planned cuts in payroll difficult to achieve



TALES  
OF THE OVERLY  
OPTIMISTIC..



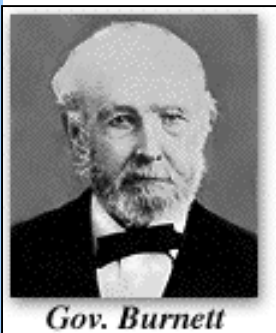
I THINK I CAN  
I THINK I CAN  
I THINK I CAN  
I THINK I CAN  
I THINK I CAN...



WIEV



*“When a State borrows money to construct some great and permanent improvement, and leaves future generations to pay the debt, she also leaves them the work itself, as some sort of compensation. The violation of principle consists in the PRESENT generation assuming to act for and to bind the next without their consent. But the case is still worse, when a State borrows money to defray the ordinary expenses of her civil administration; because she bequeaths a debt to posterity, without any means to pay it.”*



Gov. Burnett

**Peter Burnett**  
**1st Calif. Governor**

*“When I previously proposed to the Legislature that we should set something aside for unforeseen needs, some people said I was taking a defeatist attitude—that I should be thinking in terms of prosperity and not depression — but I am still of the opinion that it is no more defeatist for a State to provide for a possible rainy day than it is for an individual to do so. I am as optimistic as anyone about the economic future of our State, but I think it is elementary prudence to establish a rainy day fund.”*



**Earl Warren**  
**30th Calif. Governor**

**“Everybody is entitled  
to my opinion.”**

*Madonna*



# **How I got into Calif. budget business**

- **UCLA Anderson Forecast**
- **Econ 103**
- **Creation of School of Public Policy & Social Research**
- **PS 10B co-taught with Michael Dukakis**
- **California Policy Options starts in 1997**
- **Public event for CPO with Werner Hirsch in 2001**

**2/12/01: Hirsch and Mitchell,  
LA Times, op ed:**

*“As California’s electricity crisis unfolded, there was much talk about using the state’s “surplus” to fend off high energy costs. ... There is one problem... In the current fiscal year ending June 30, California is running a deficit. And the budget proposals for next fiscal year similarly project a deficit.”*





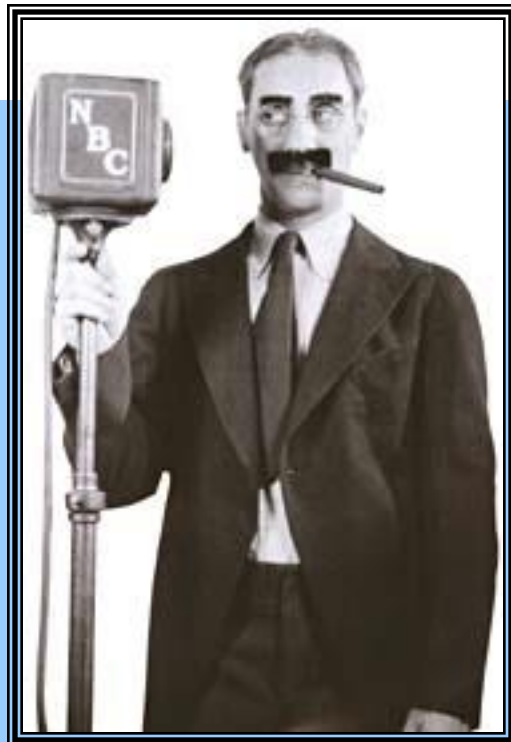
# 2/23/01: Tim Gage, State Director of Finance, LA Times, Letter to the Editor

*“The charge by (Hirsch and Mitchell) that California is running a deficit is flatly untrue.”*



***“Who are you gonna believe? Me or your own eyes?”***

**Groucho Marx**



# 12/18/02: Tim Gage, State Director of Finance, quoted in Gov. Davis' press release announcing Gage's replacement

*“I look forward to other opportunities that will allow me to spend more time with my family.”*



Steve Peace ← ?



# John Vasconcellos

## Dem. Senator - San Jose



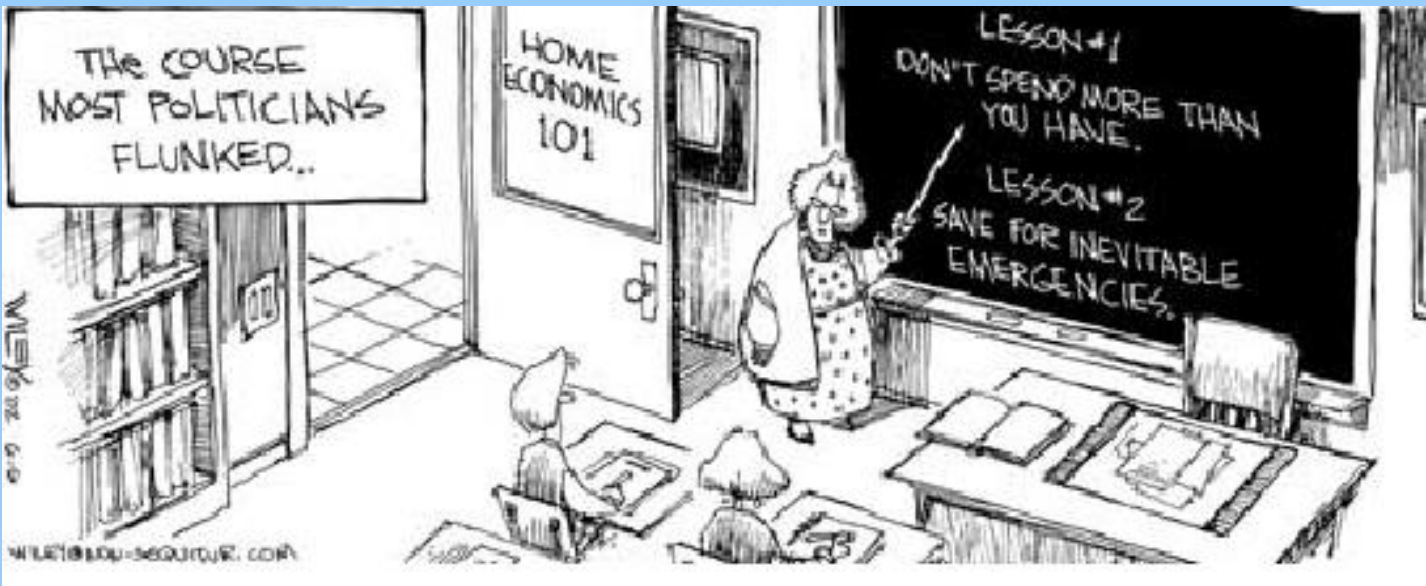
*“I have never been so frightened  
about California’s future as I am  
now. The ingredients seem to be  
here to take the state right over the  
cliff.”*



# Keith Richman Rep. Assemblyman - Northridge



*“Without bipartisan  
cooperation, we are headed for  
a fiscal train wreck.”*



**Why does California  
feel exempt?**

# If California were a country, it would be the...

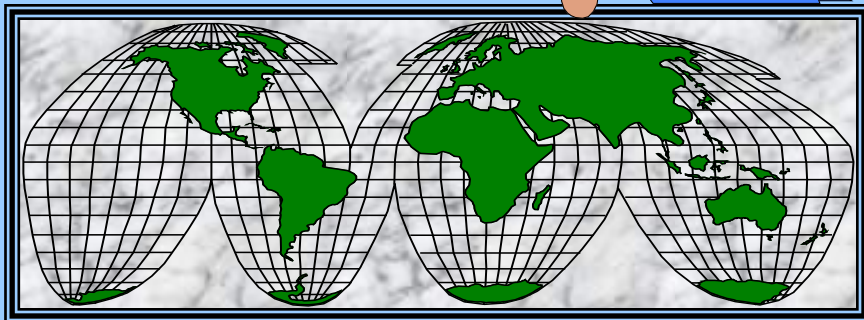
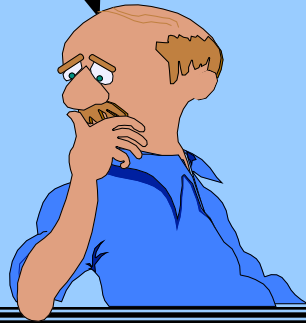
- 5th
- 6th
- 7th
- 8th



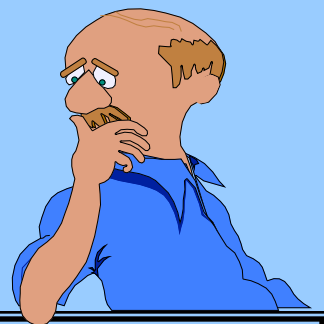
largest country in the world depending on the year chosen.

## What does this statement mean?

**What  
makes a  
country?**



# Having a government?



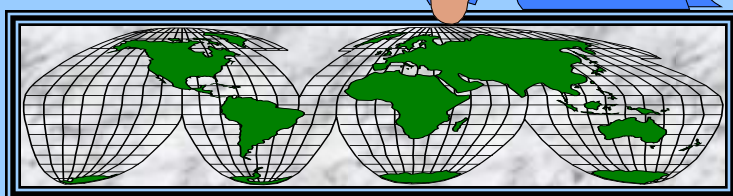
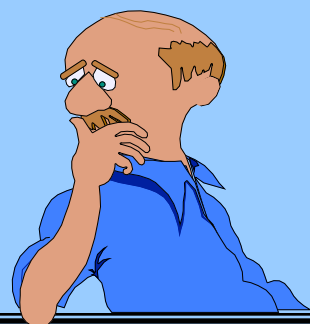


# Belonging to the UN?

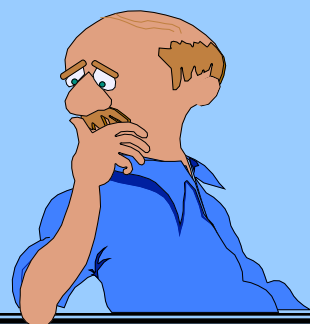


**Switzerland?**

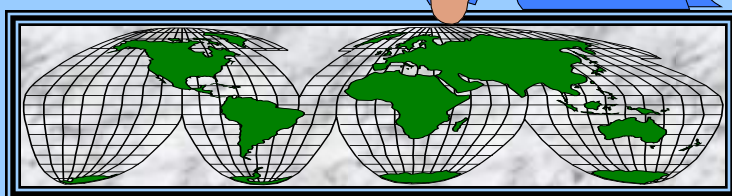
**Taiwan?**



# Having a post office and issuing stamps?



UN?



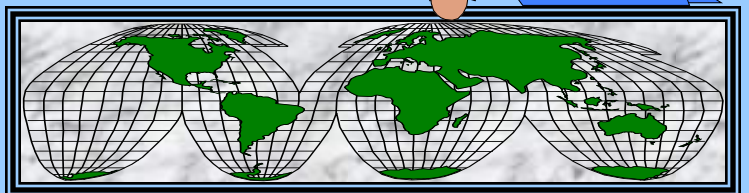
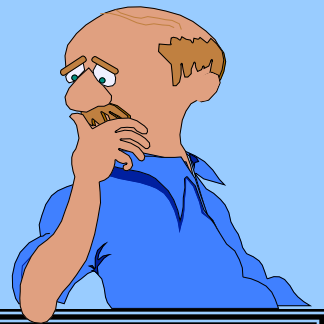
# Speaking a common language?



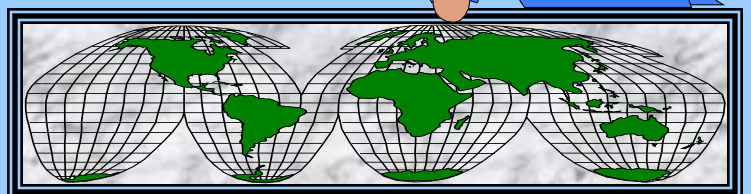
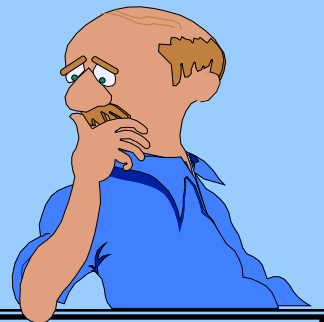
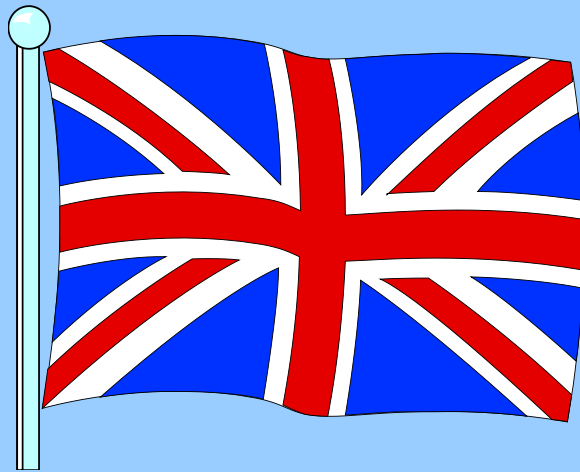
*The Tower of Babel  
by Pieter Bruegel (c. 1525-69)*

**Belgium?**

**India?**



# Having a flag?

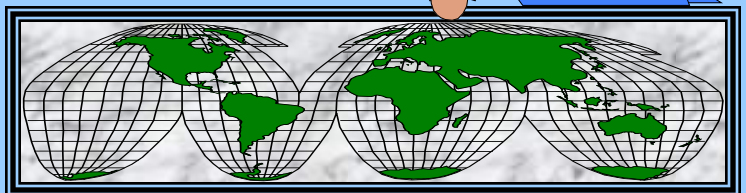
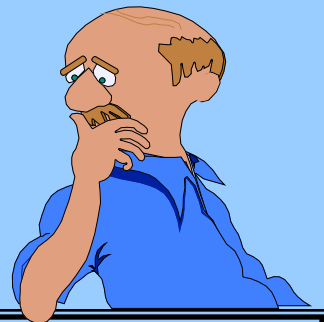


# Sovereignty?

**“I am the master of  
my fate;  
I am the captain of  
my soul.”**

**William Ernest Henley**

*Invictus*

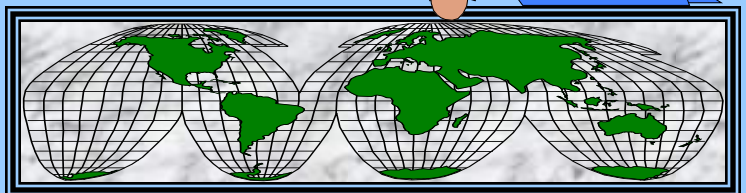
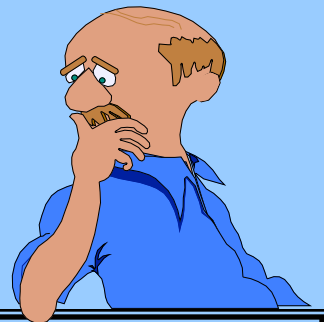


# Fiscal Sovereignty?

**“I am the master of  
my fate;  
I am the captain of  
my soul.”**

**William Ernest Henley**

*Invictus*





# *California has no Alan Greenspan*

- **There is no  
California  
currency**



- **Its govt.  
can't run big  
deficits for  
long periods**

U.S. MAIL PERMIT NO. 1000 LOS ANGELES, CALIF. POSTAGE WILL BE PAID BY ADDRESSEE

Los Angeles Times | Wednesday

# CLASSIFIED

CLASSIFIED  
JULY 1974

1974 JUL 10 11:00 AM

THE TIMES

WEDNESDAY

## How To Get Free Money From The U.S. Government!

Can You Qualify To Get FREE Grant Money & Interest-Free Loans From Uncle Sam?

Learn how to get free money from the U.S. Government. This is a new program that will help you get free money from the U.S. Government.



As a result of this program, you can get free money from the U.S. Government. This is a new program that will help you get free money from the U.S. Government.



Learn how to get free money from the U.S. Government. This is a new program that will help you get free money from the U.S. Government.



Learn how to get free money from the U.S. Government. This is a new program that will help you get free money from the U.S. Government.



### WILLIAM J. BAKER

Mr. Baker is a member of the U.S. House of Representatives. He is a member of the U.S. House of Representatives. He is a member of the U.S. House of Representatives.

### WILLIAM J. BAKER

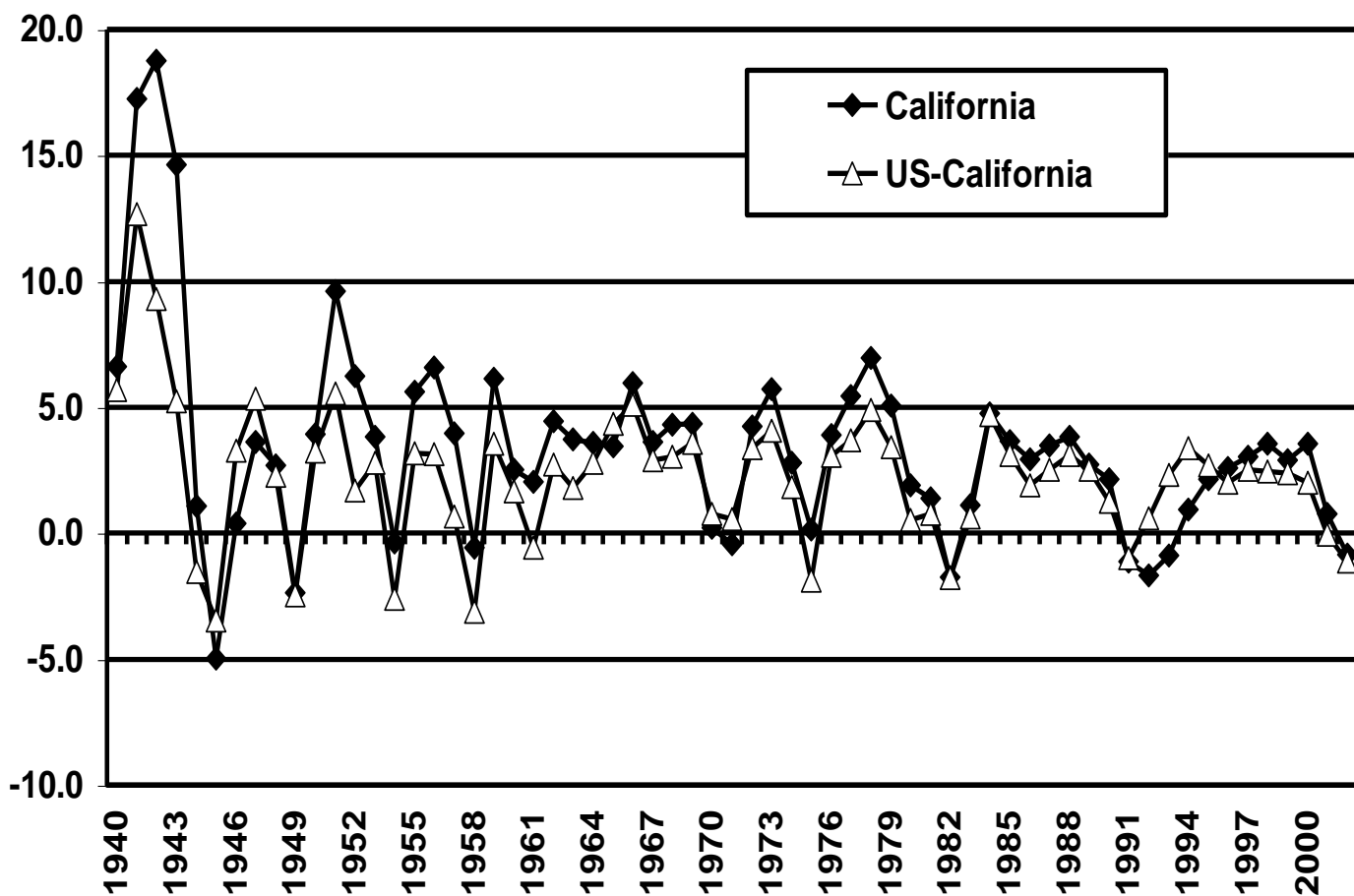
Mr. Baker is a member of the U.S. House of Representatives. He is a member of the U.S. House of Representatives. He is a member of the U.S. House of Representatives.

### WILLIAM J. BAKER

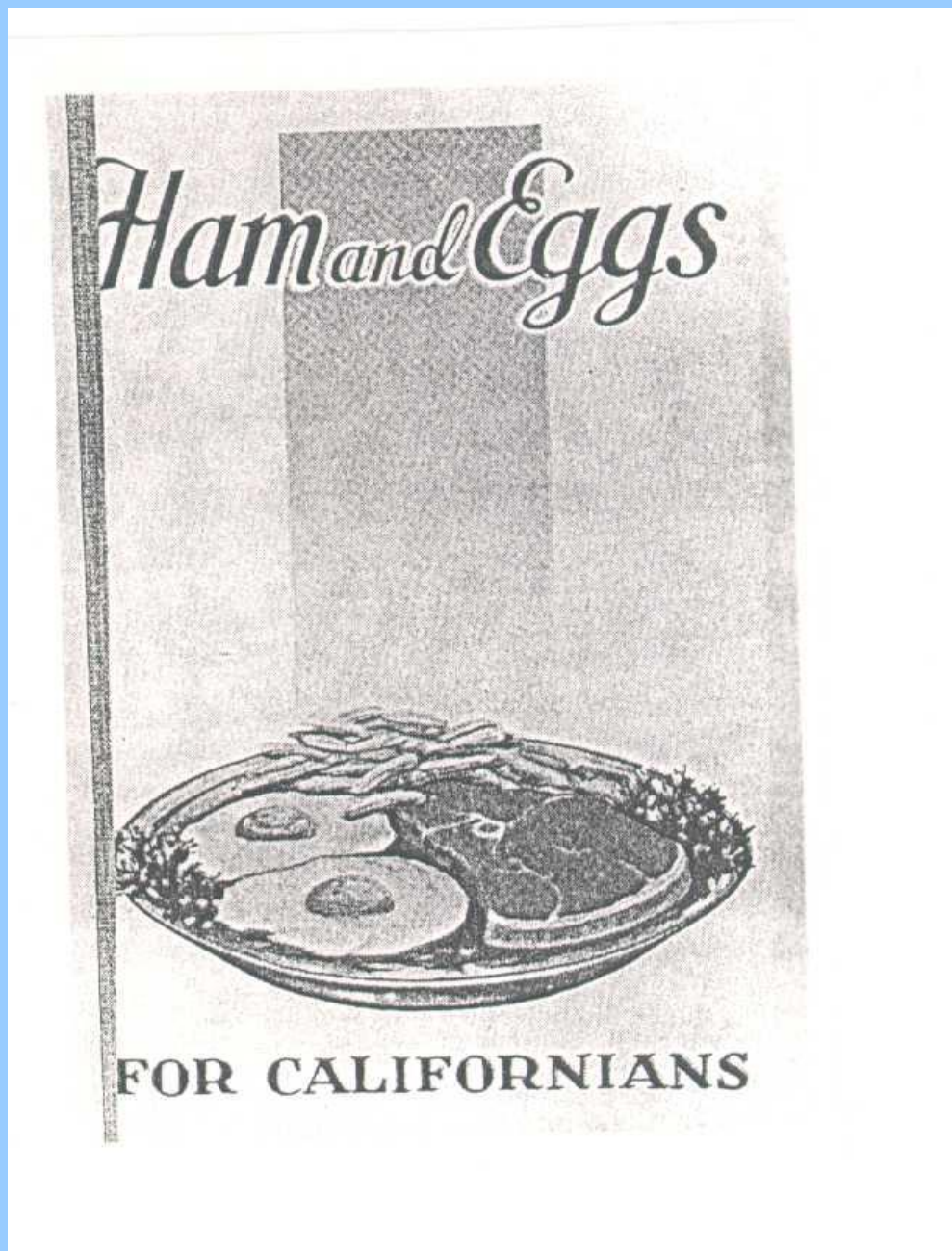
Mr. Baker is a member of the U.S. House of Representatives. He is a member of the U.S. House of Representatives. He is a member of the U.S. House of Representatives.

# Percent Change in Nonfarm Payroll Employment: California vs. Rest of U.S.

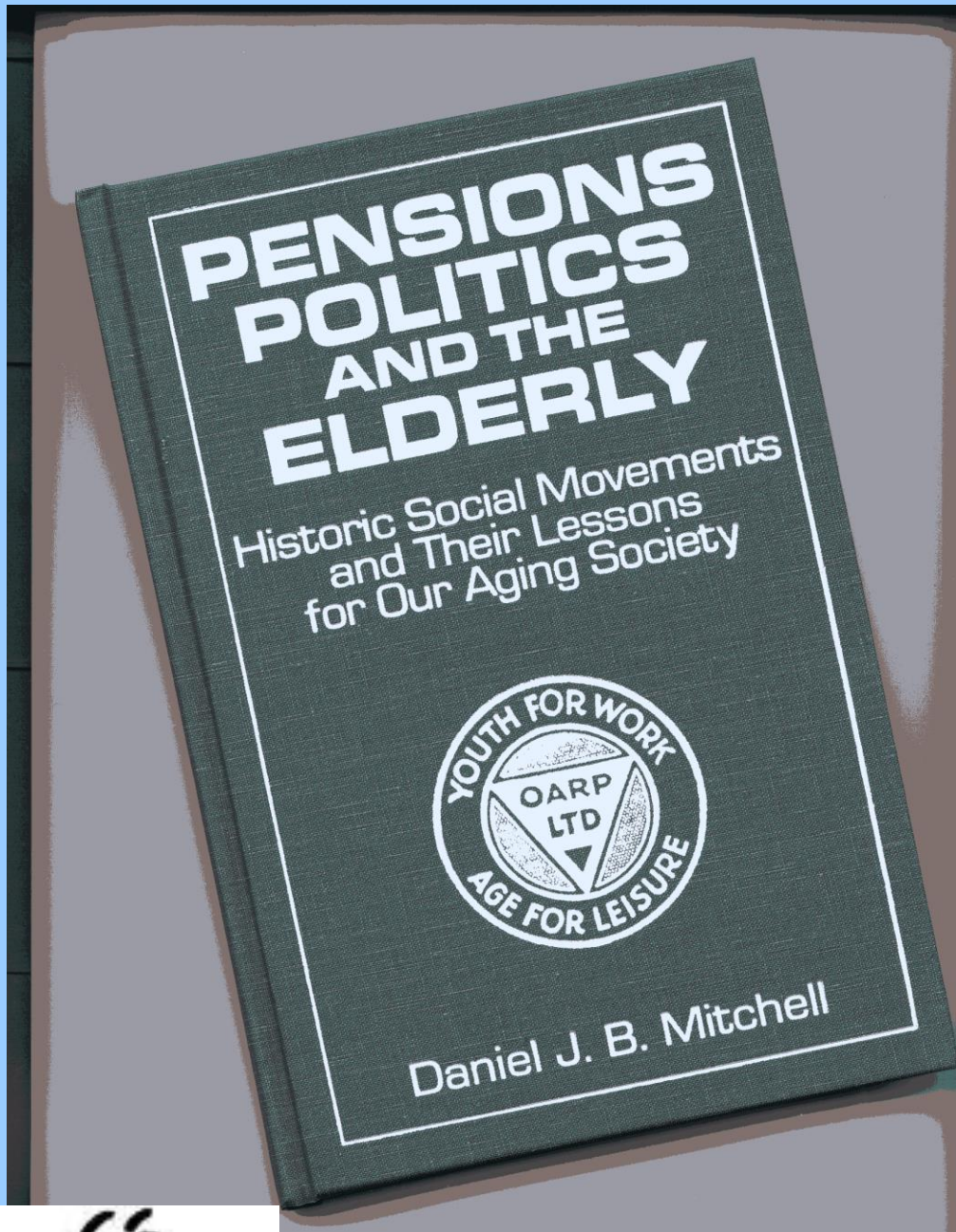
CALempl.xls  
CalvsUS



*Nonetheless...*







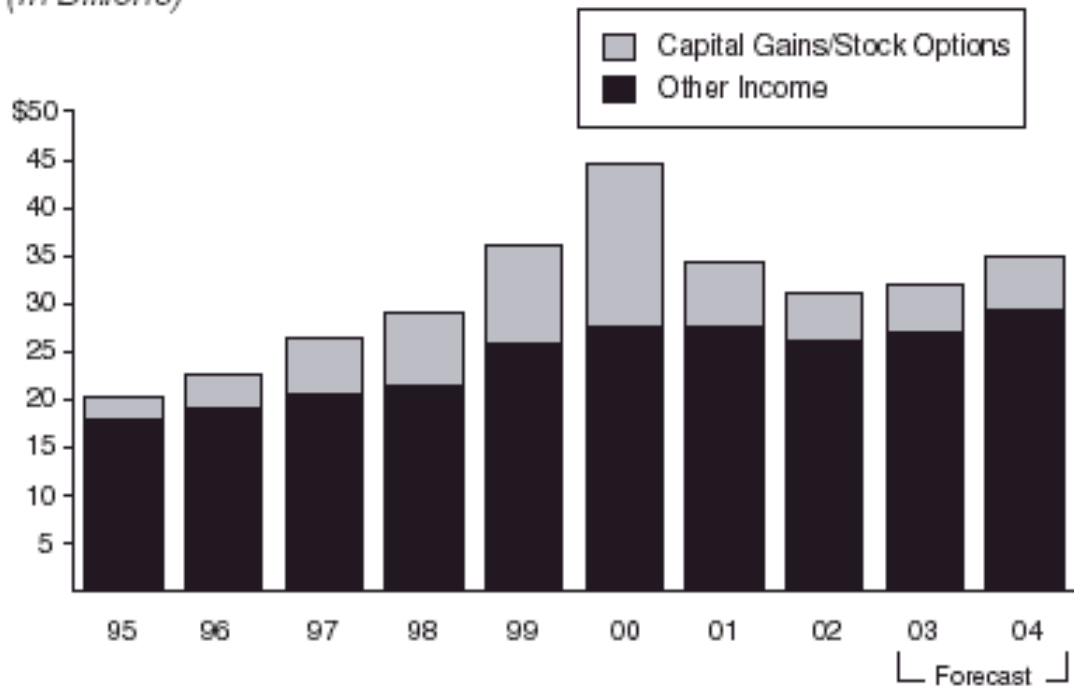
*Shameless plug:*

Available at  
[www.mesharpe.com](http://www.mesharpe.com)

Figure 6

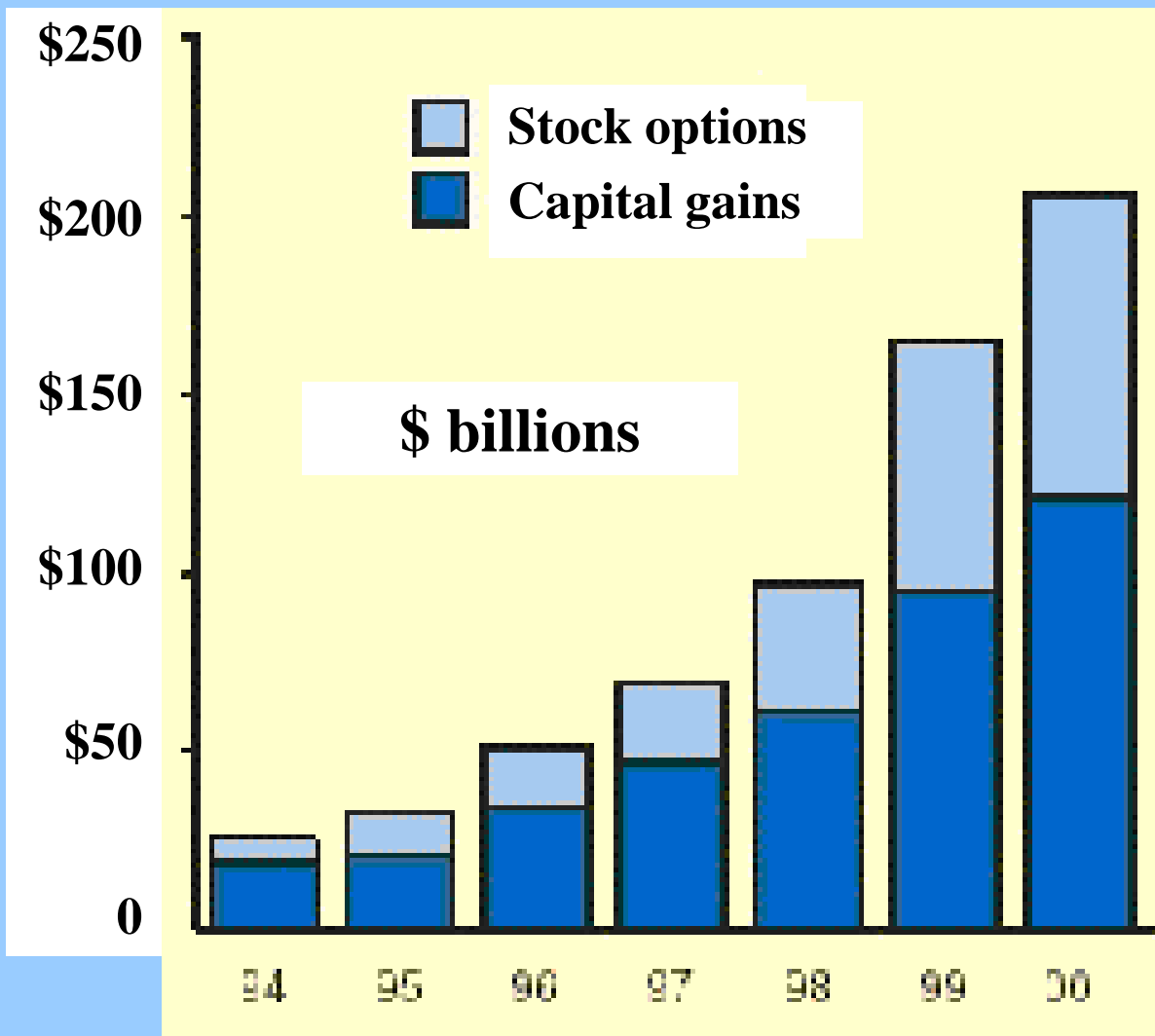
### After Plunging, PIT Liabilities to Grow Moderately

*California Annual PIT Liabilities, by Source  
(In Billions)*

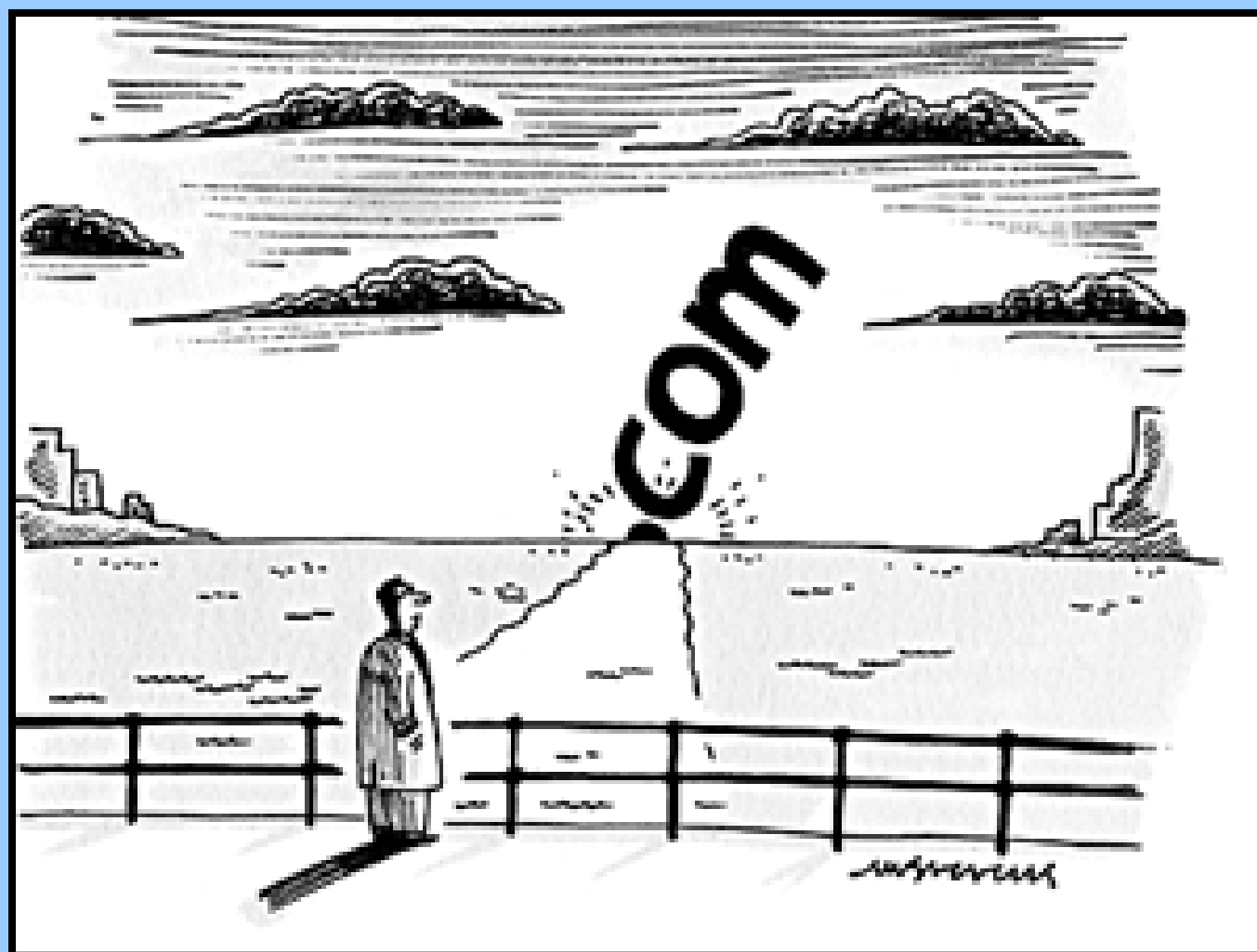


**In FY 2000-01, personal income taxes produced \$17 billion in revenue from capital gains (22% of general fund revenue).**





**Taxable stock options and other taxable capital gains in the 1990s**

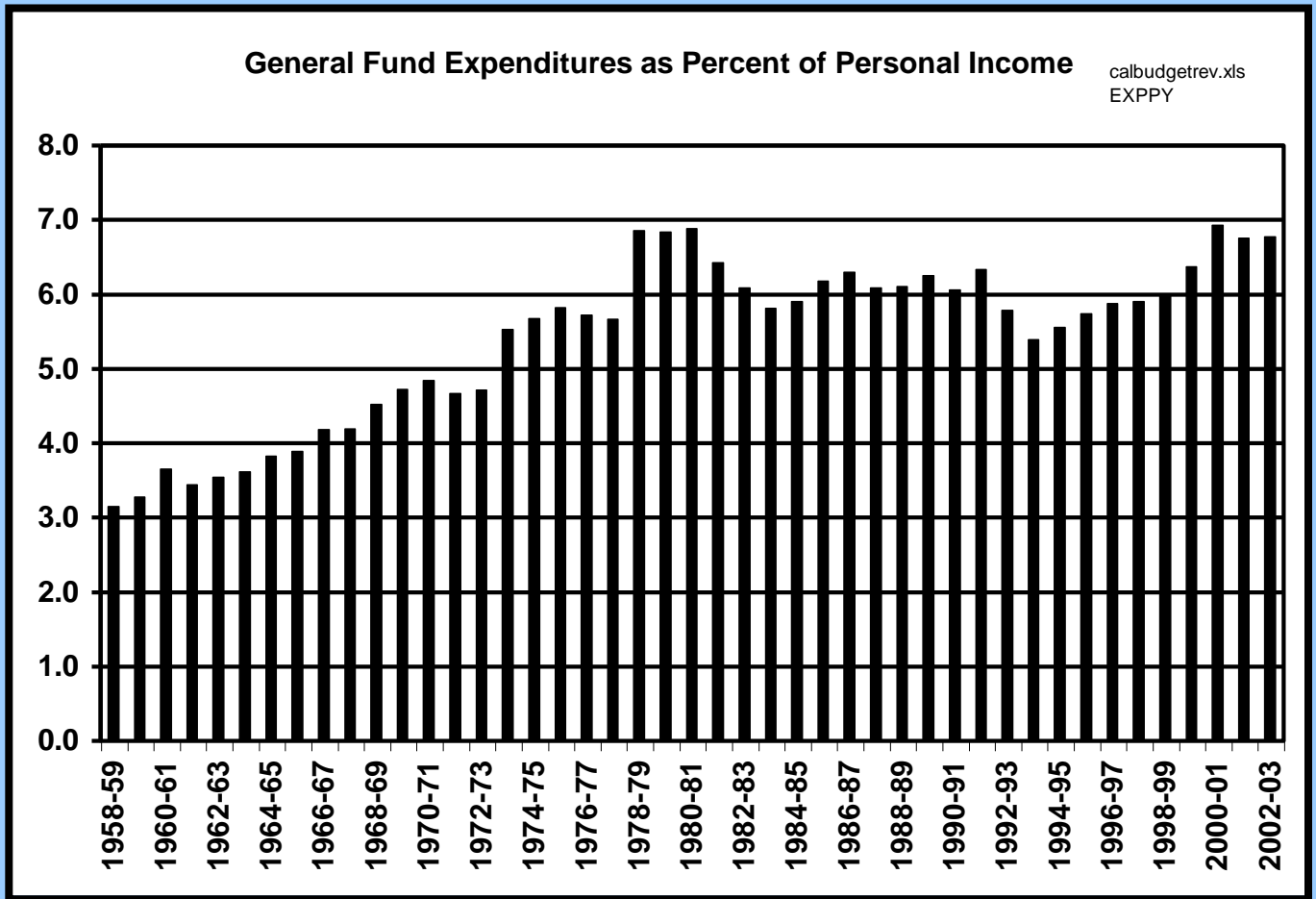


***“That which cannot go  
on forever must come to  
an end.”***



**Herb Stein**

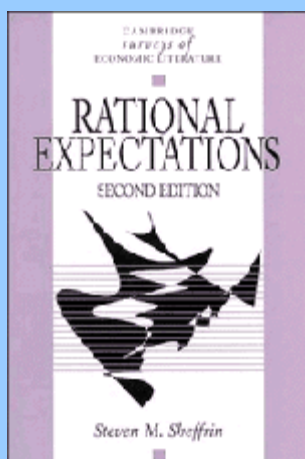
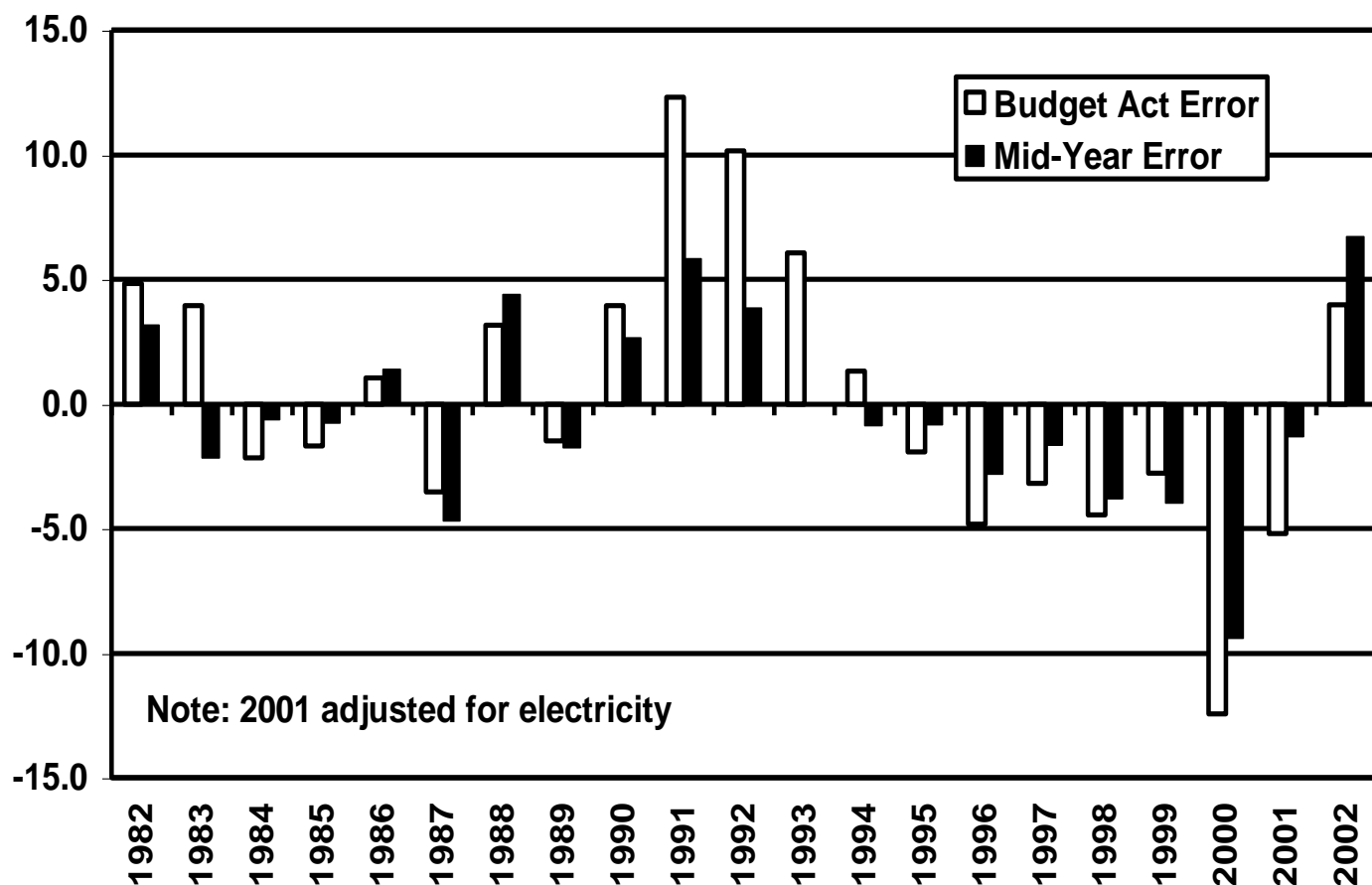
# Record Spending and Deficit at Peak Guarantees Budget Crisis in Downturn



# Was the Drop in Revenue a Surprise?

Percent Revenue and Transfer Forecasting Errors: General Fund  
(Fiscal Years Ending June 30 of Year Shown)

CPObudget2004.xls  
RevForecast

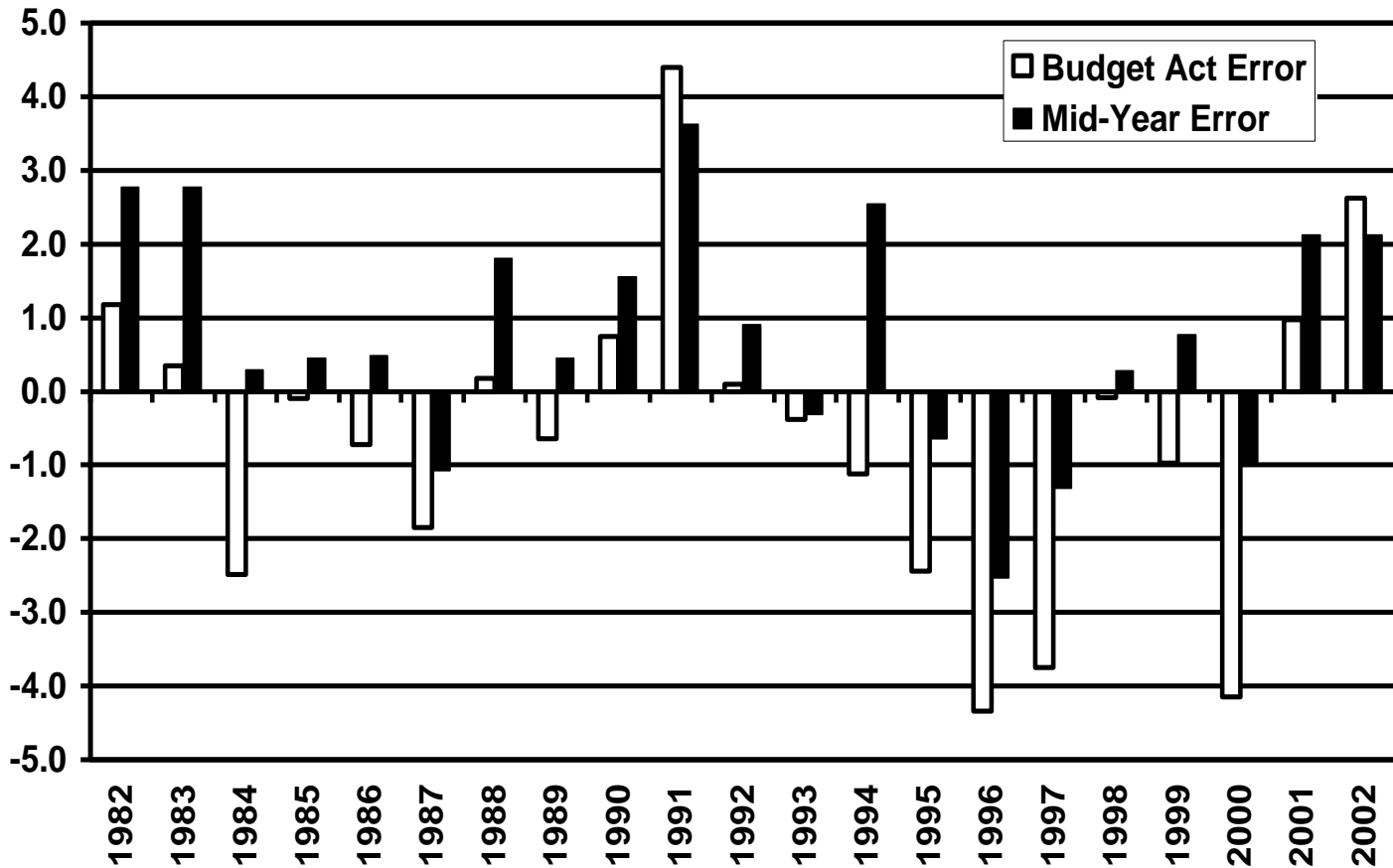


**Tendency to underestimate  
revenue in Good Times,  
overestimate in Hard  
Times**

# What about expenditure forecasts?

Percent Expenditure Forecast Error: General Fund  
(Fiscal Year Ending June 30 of Year Shown)

CPObudget2004  
ExpForecast



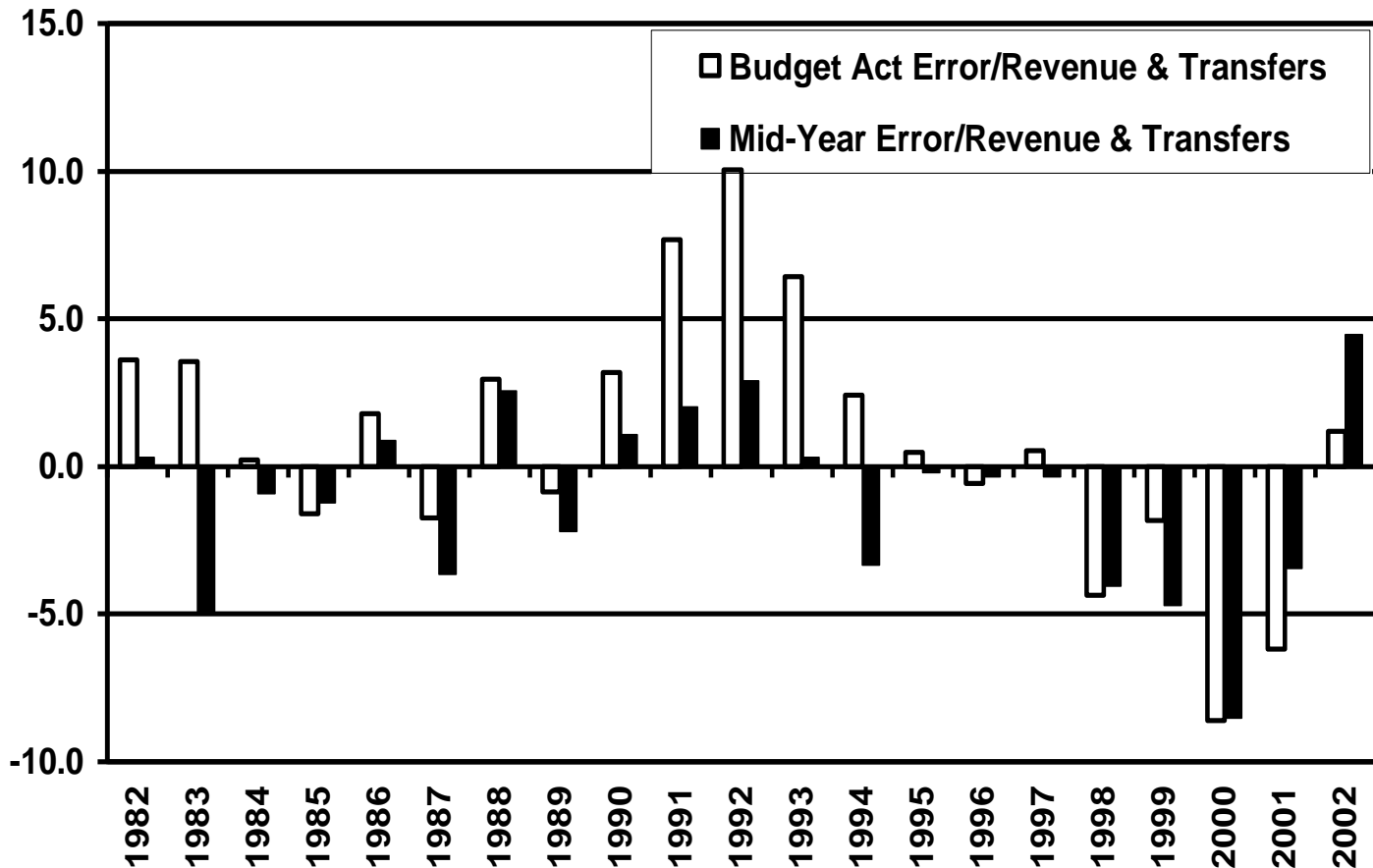
**Tendency to underestimate  
spending in Good Times,  
overestimate in Hard  
Times**



# And the budget surplus (deficit)?

**Percent Surplus or Deficit Error: General Fund  
(Fiscal Year Ending June 30 of Year Shown)**

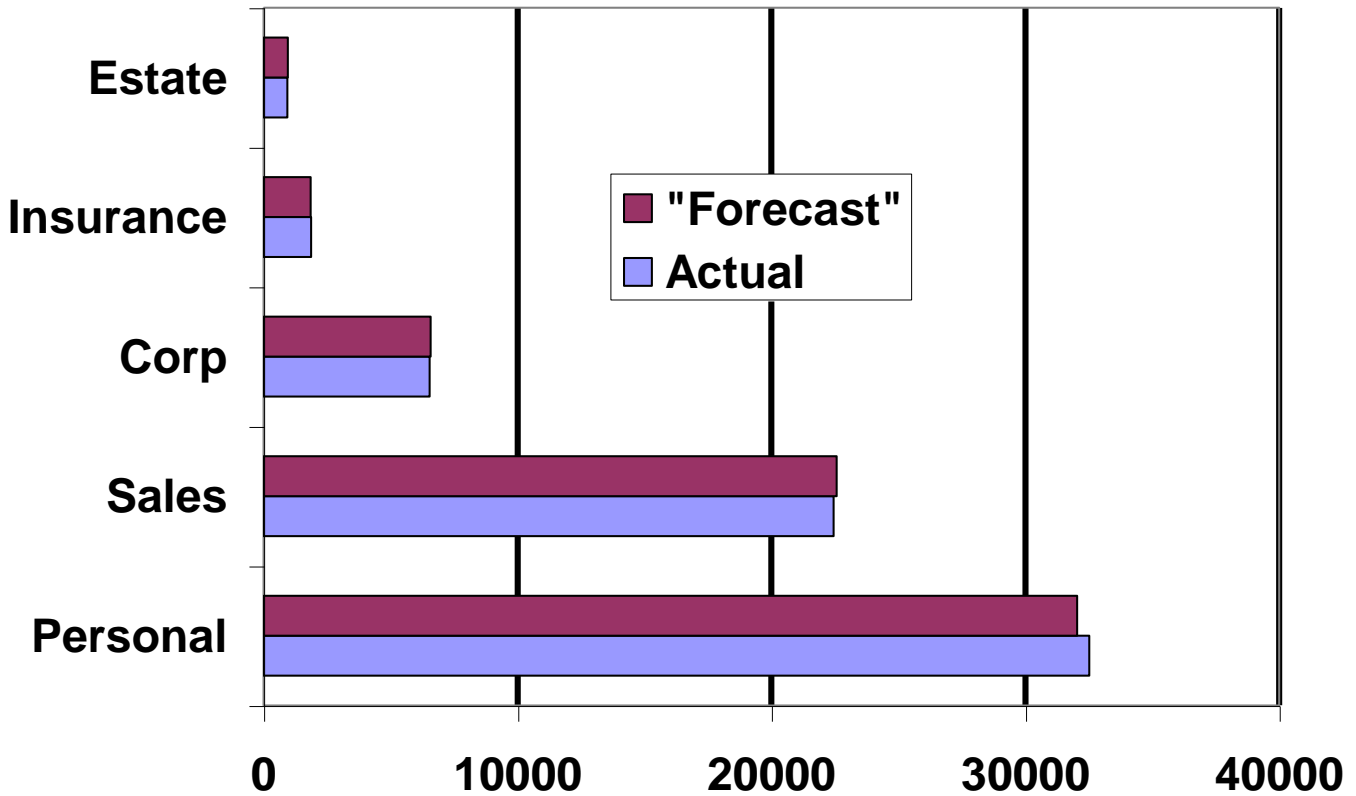
CPObudget2004.xls  
SurpForecast



**Underestimate  
surplus in Good  
Times;  
overestimate in  
Hard Times**

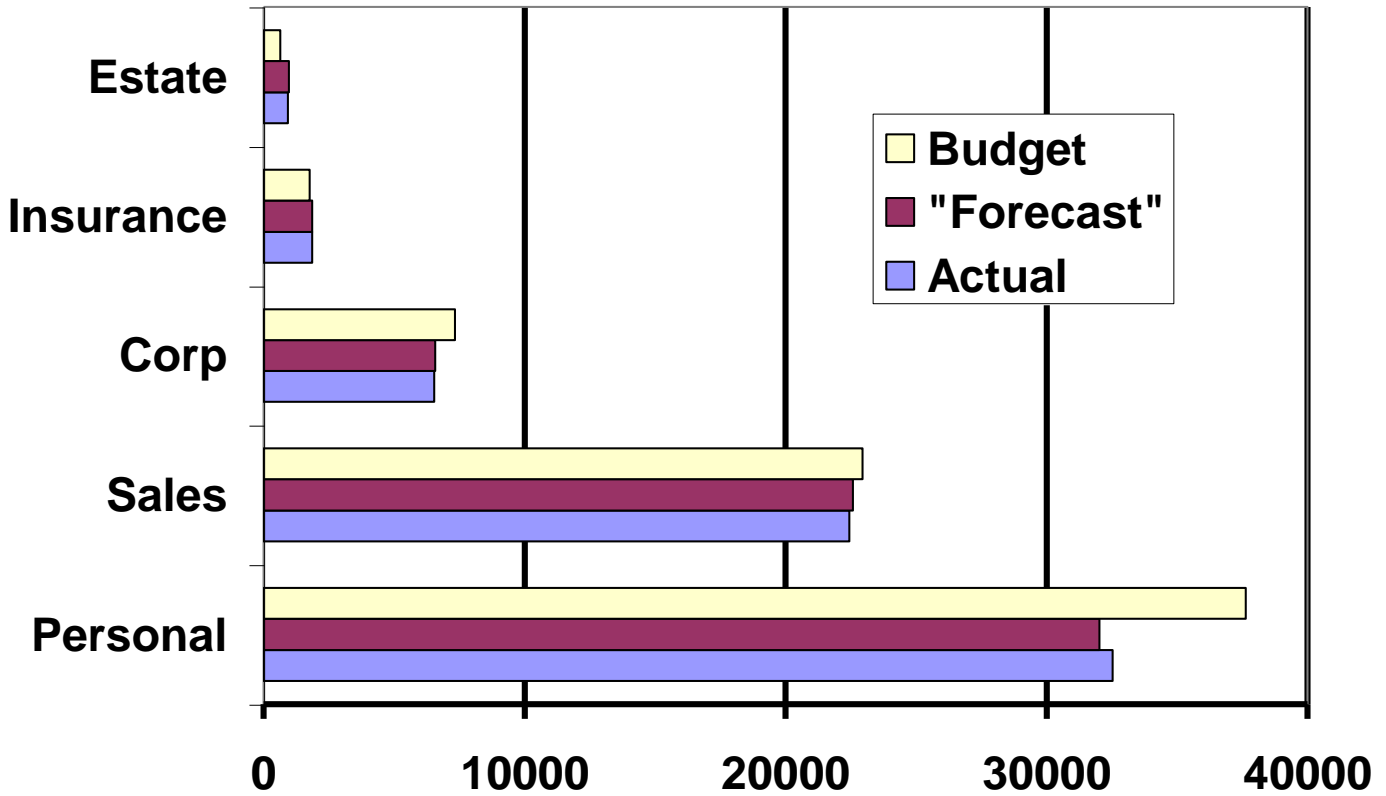
# What's a "Forecast"?

**DOF Reported Results for 2002-03**  
**(\$ millions)**



# What's a "Forecast"?

**Same Chart with Original Budget Added  
(\$ millions)**



# *Electricity Deregulation and Crisis of 2001*



# *Electricity Deregulation and Crisis*

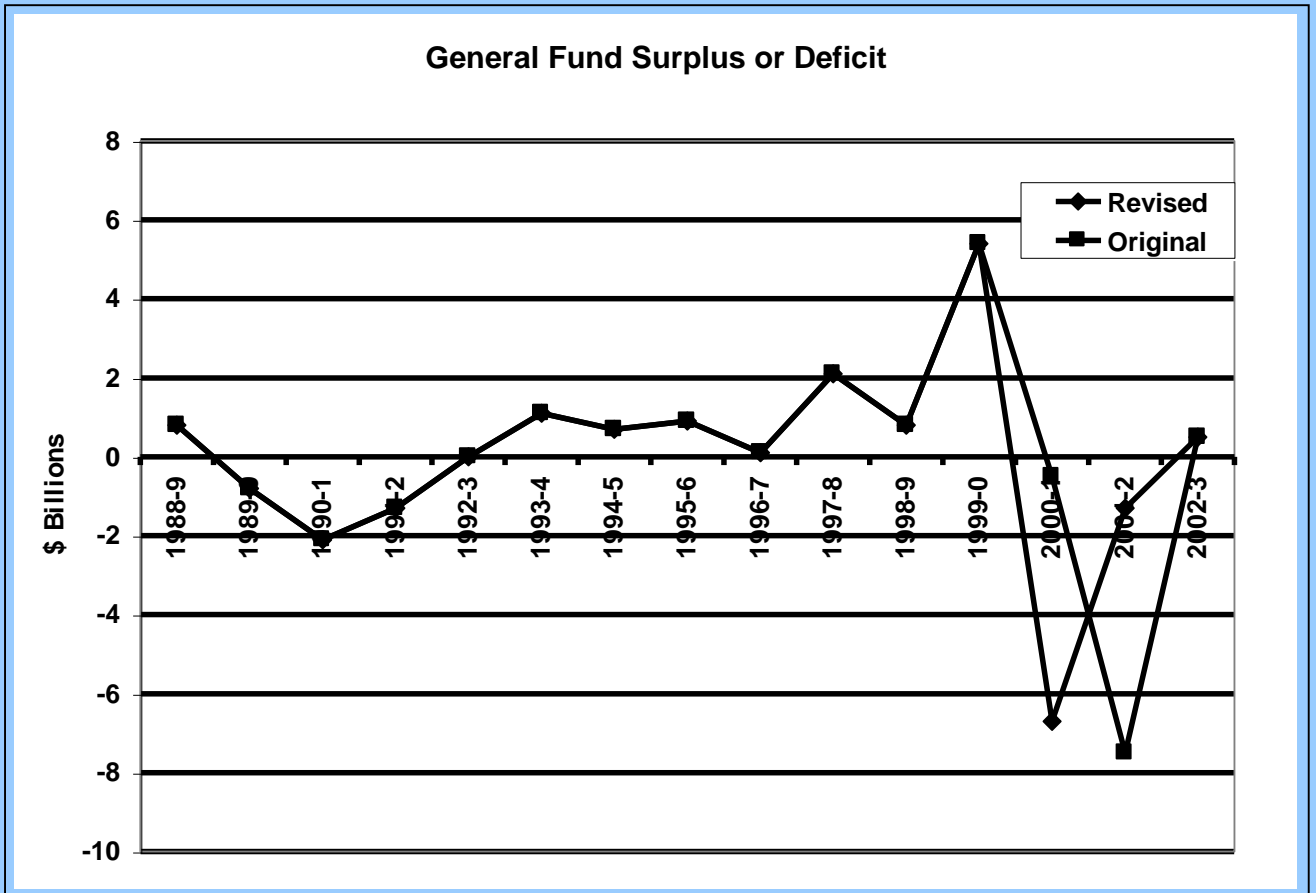


may



**\$6+ billion: Off the books  
or negative transfer?**

# Inconsistent Accounting for Electricity Spending



**Governor's budget treatment changes to move big deficit into past when proposing 2002-03 budget**





Juggling the Numbers



FINANCIAL ACCOUNTING STANDARDS BOARD



Governmental Accounting Standards Board



THE CHRISTIAN SCIENCE MONITOR Bennett

Juggling the Numbers

# \$38 Billion



## What Does It Mean?

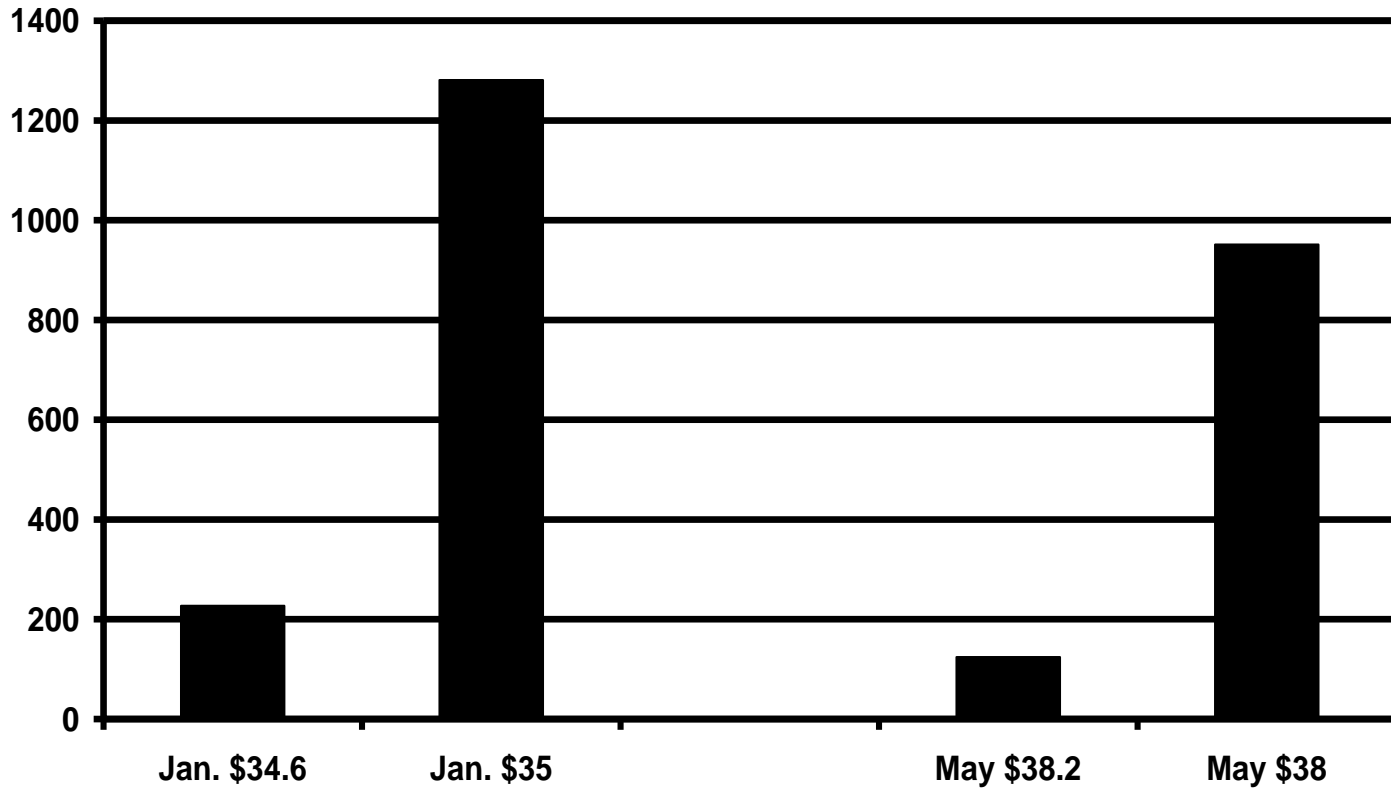
# \$38 Billion



**Nexis-Lexis Citations:**  
**1 Month**

## Number of Media Citations Within One Month of 2003 Budget Announcements for FY 2003-04

calopinion.xls  
nexuslexis



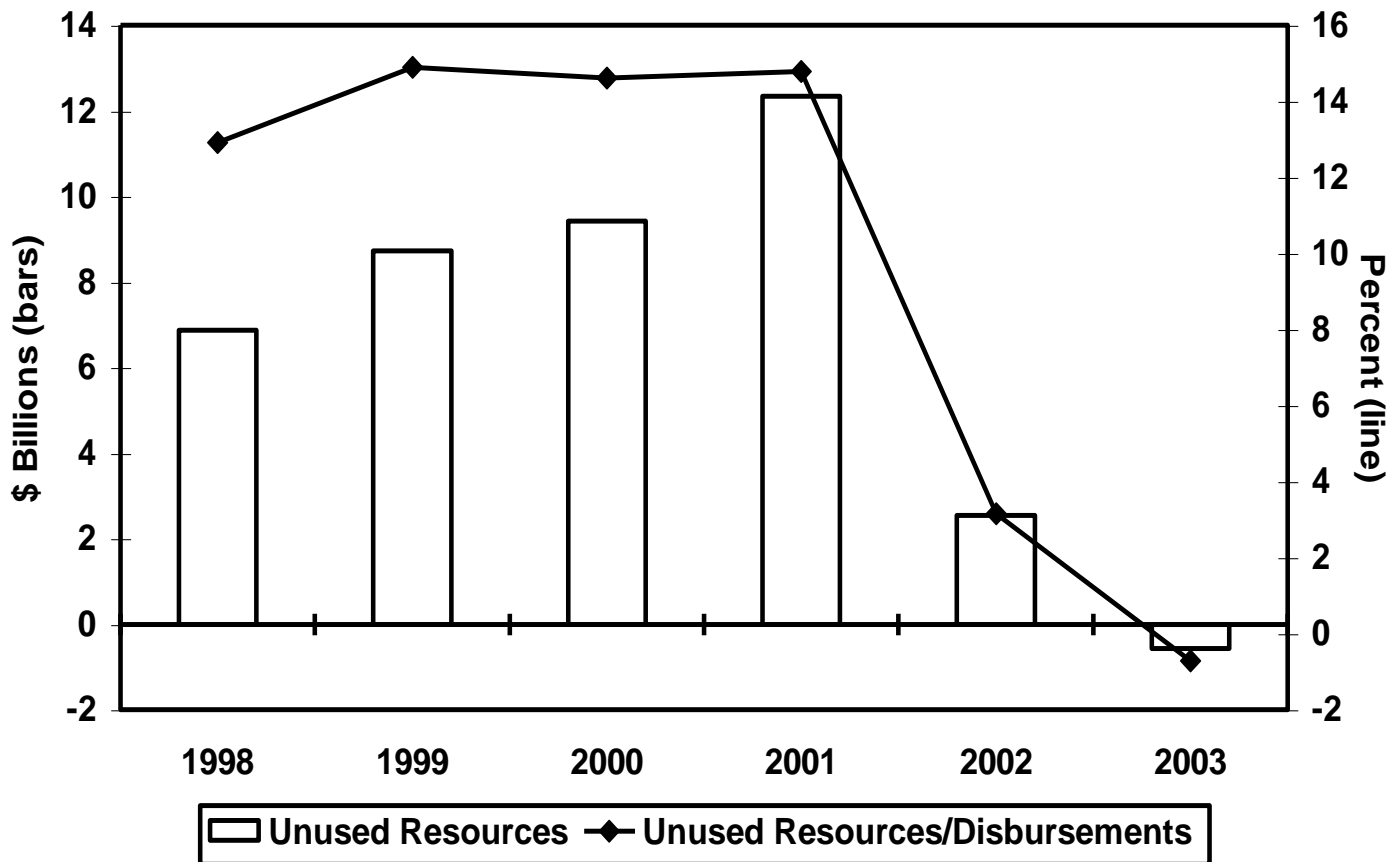
Note: Citation count for all periods as of July 12, 2003.



# ...all others pay cash.

Unused Borrowable Resources Excluding RAWs:  
June 30 of Year Shown

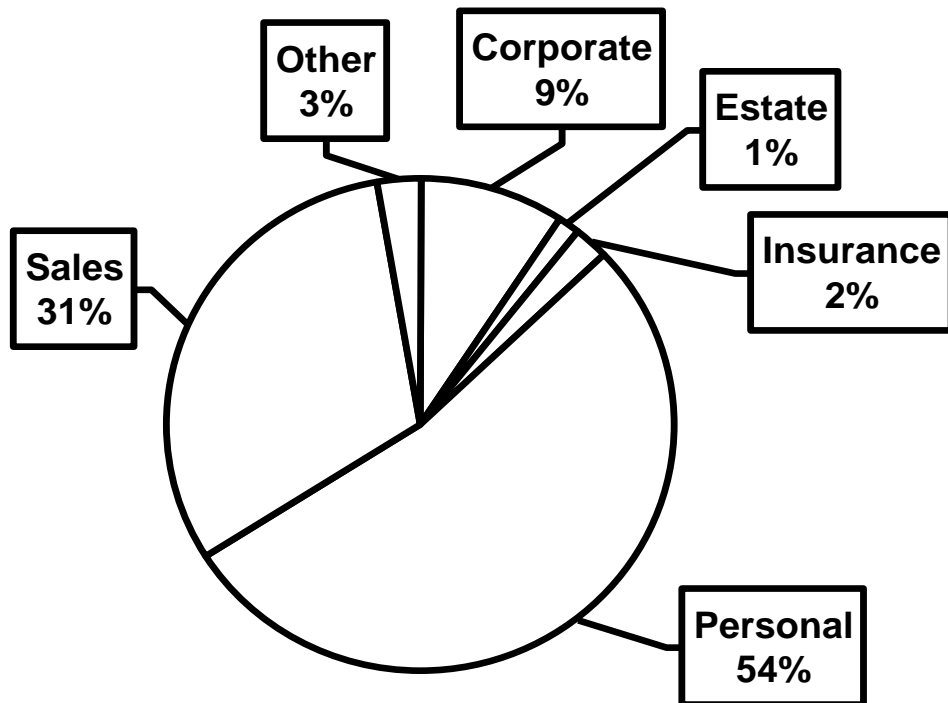
calborrow.xls  
resources



# *Budget Structure*

## General Fund Revenue Sources: 1997-98 - 2002-03

calborrow.xls  
source%



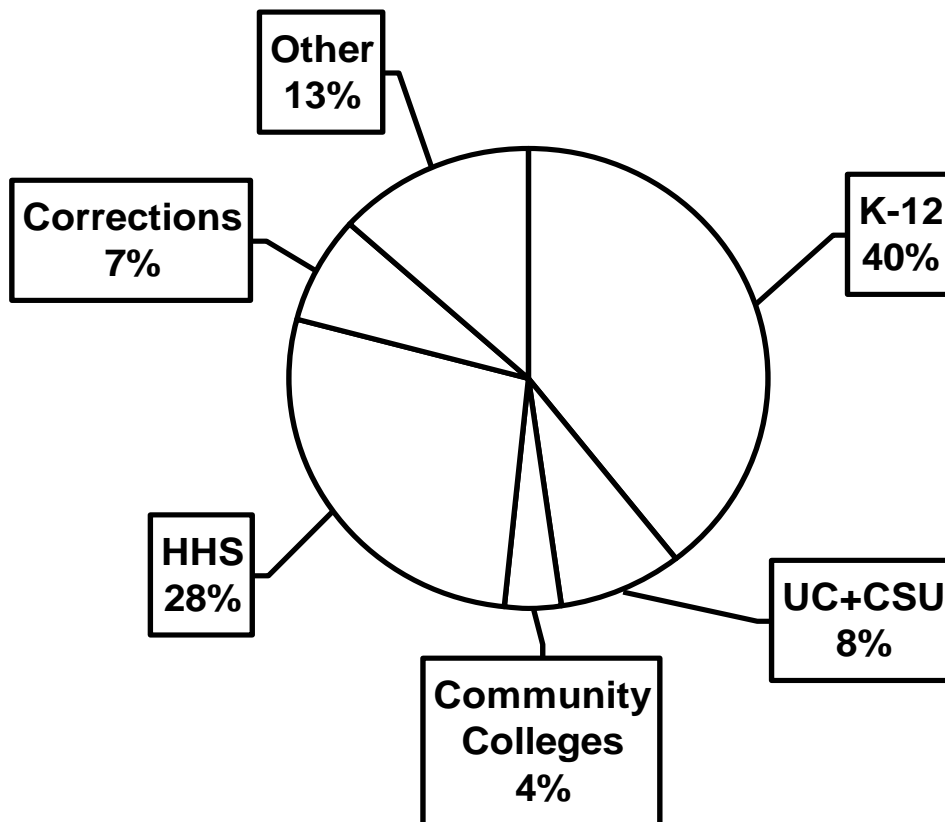
**Note: Excludes tobacco bond revenue in 2002-03.**



# *Budget Structure*

**General Fund Expenditure Categories: 1997-98 - 2002-03**

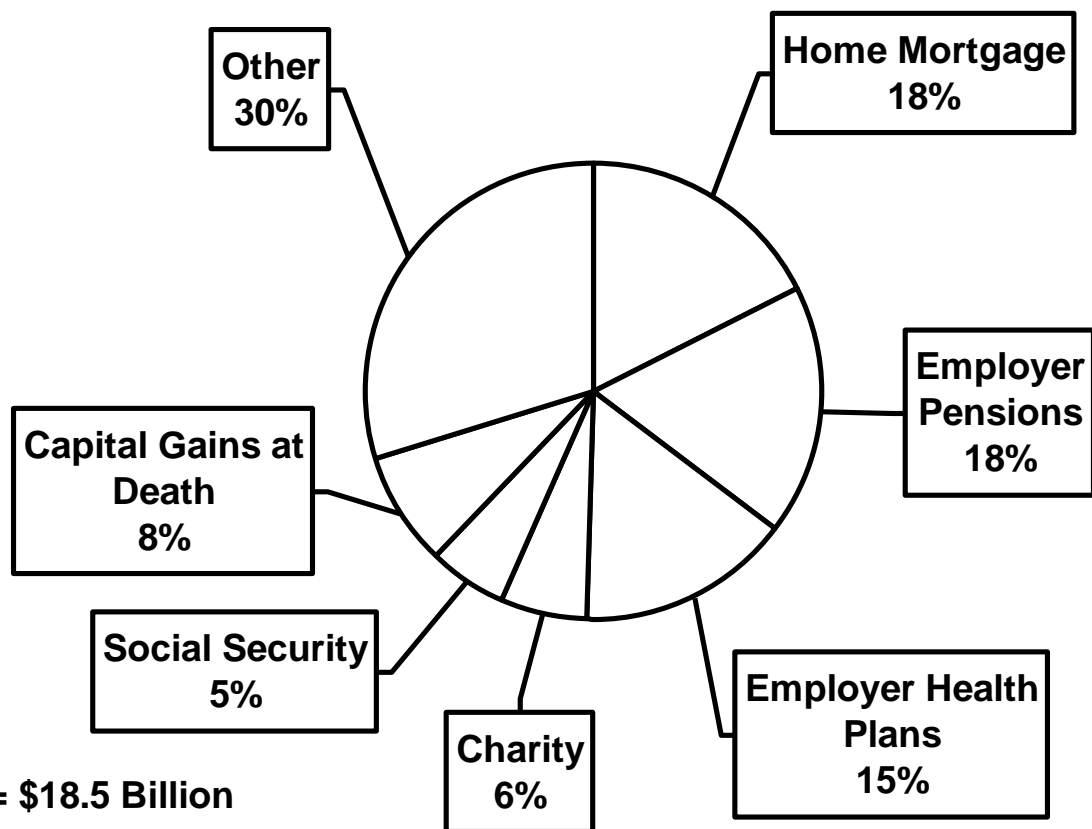
CPObudget2004.xls  
spend%



# *Budget Structure*

## Tax Expenditures from Personal Income Tax: 2002-03

cataxexpend.xls  
Pie0203

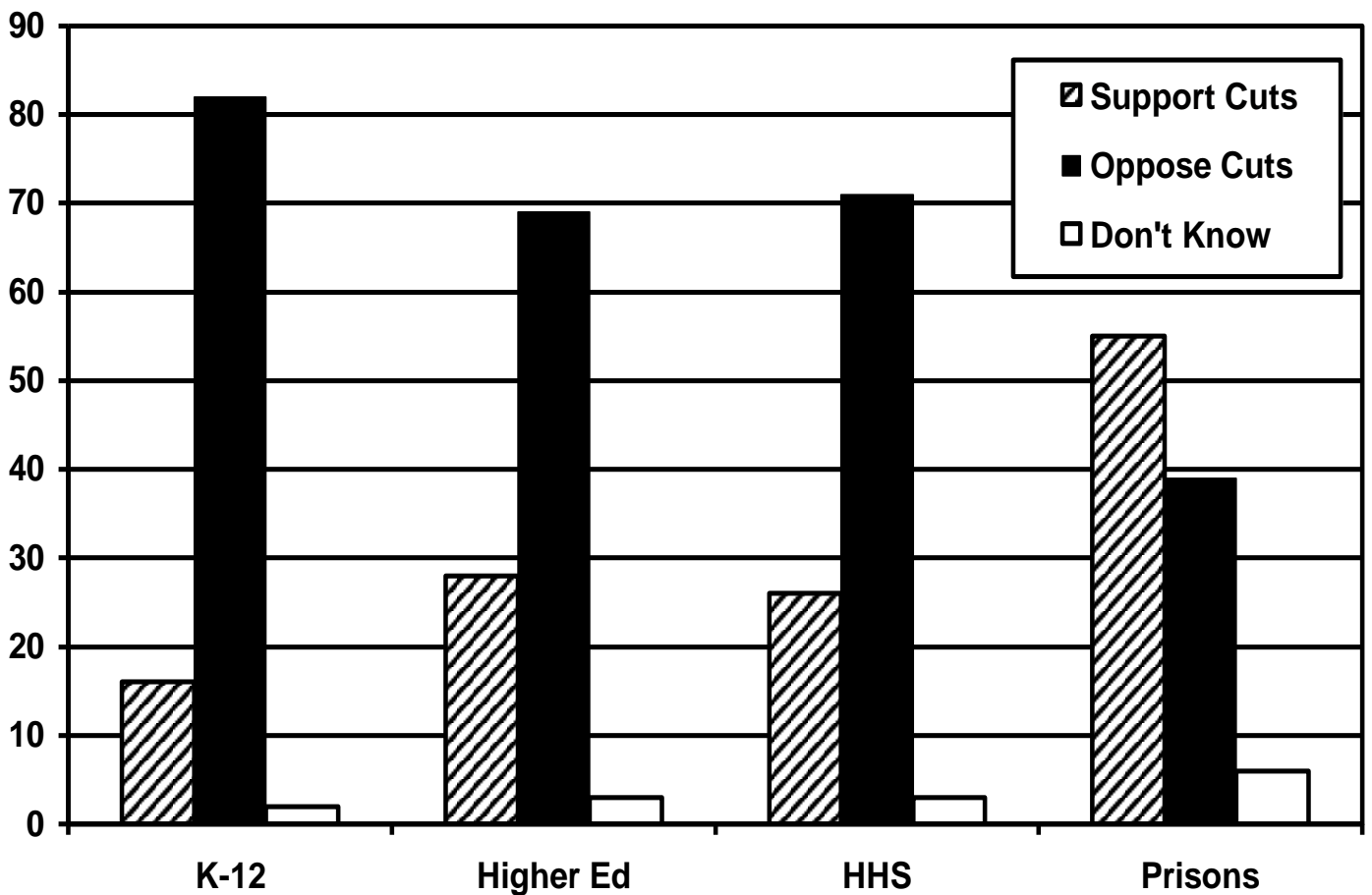


Total = \$18.5 Billion

# Public Opinion (PPIC)

Opinions of Adult Californians Regarding  
Possible Spending Cuts (Percent)

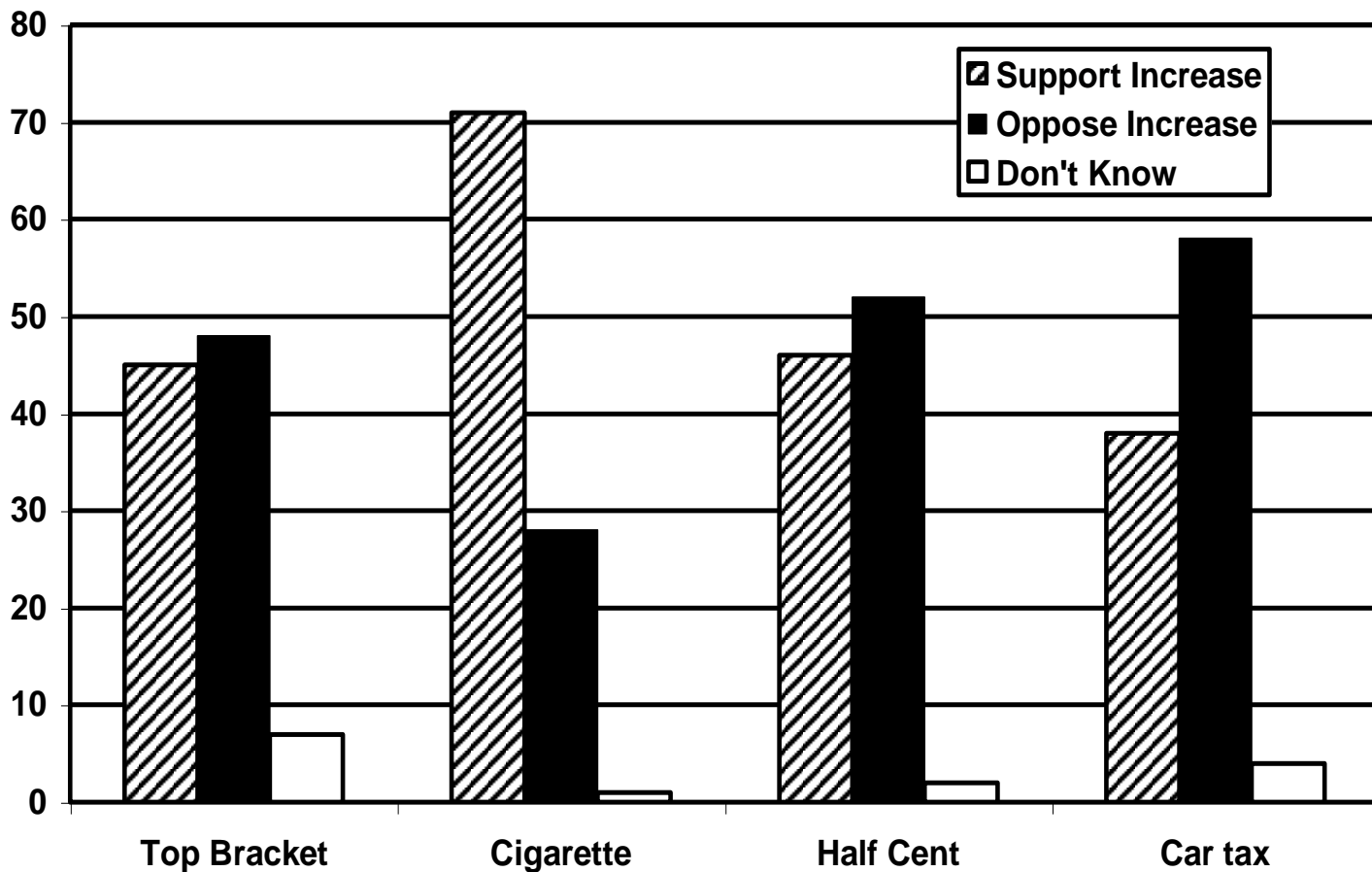
calopinion.xls  
spendcut



# Public Opinion (PPIC)

Opinions of Adult California Regarding  
Potential Tax Increases (Percent)

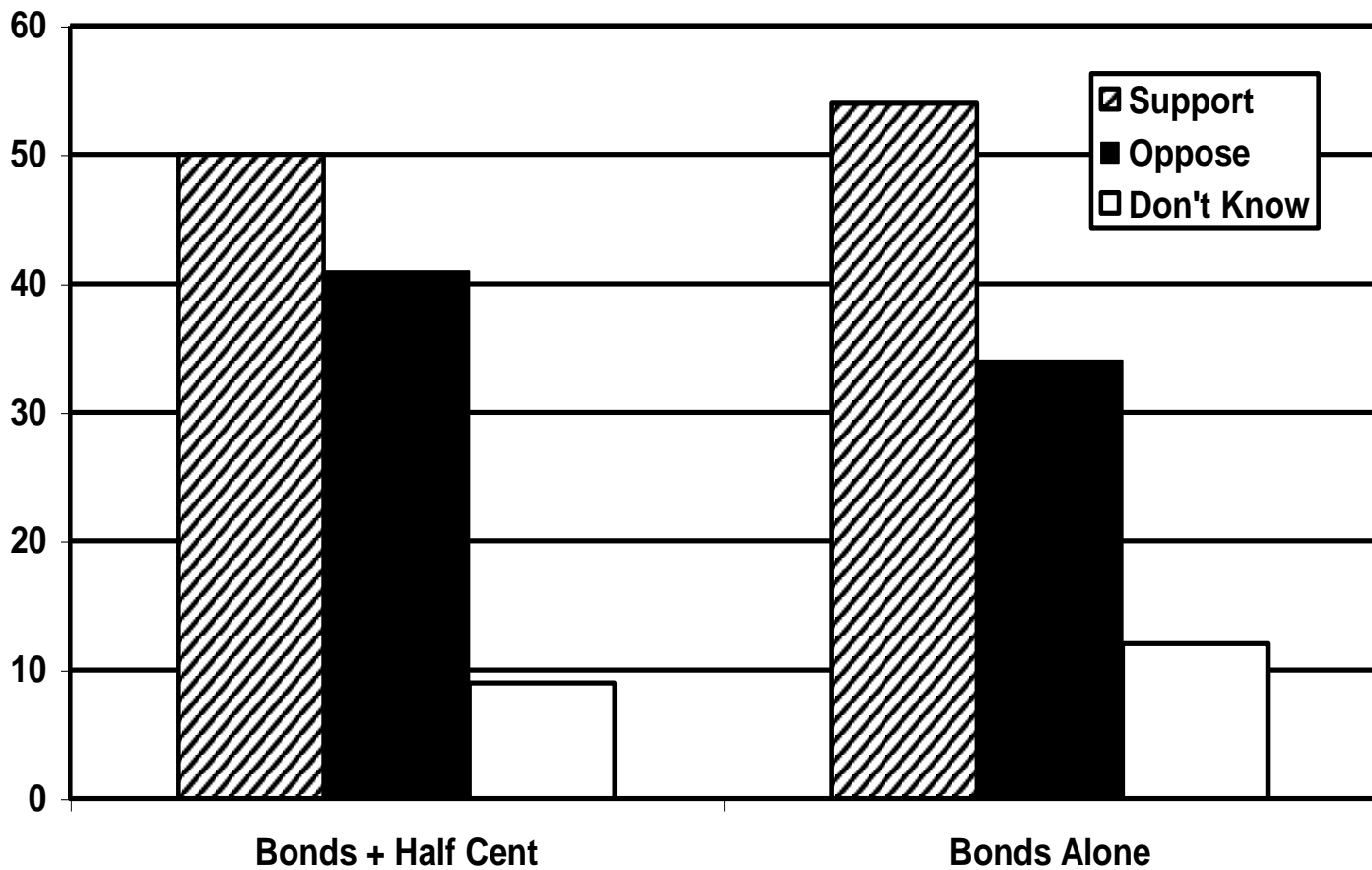
calopinion.xls  
taxup



# Public Opinion (PPIC)

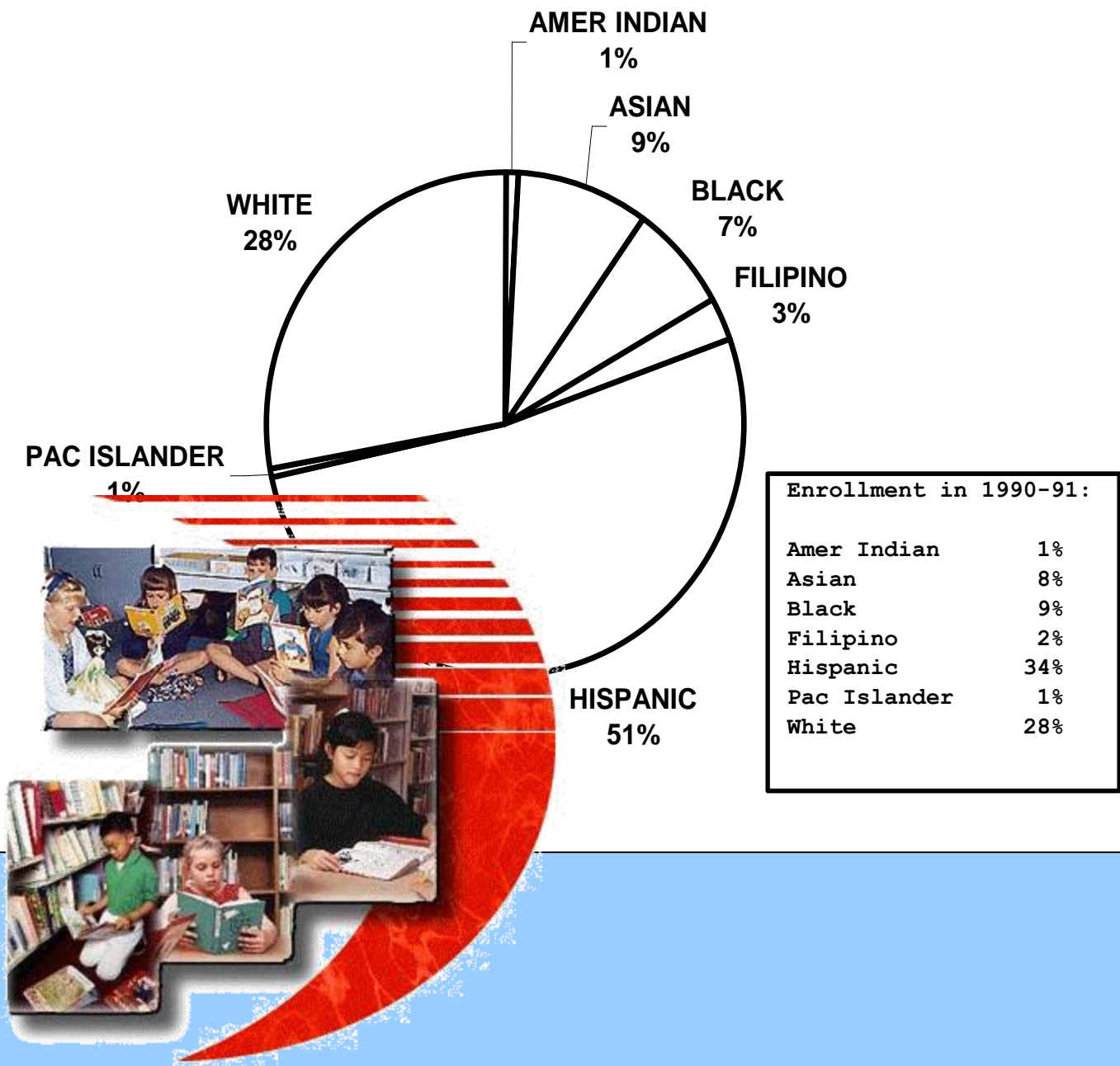
Opinions of Adult Californians Regarding  
Deficit Finance (Percent)

calopinion.xls  
borrow



# *Changing Demographics*

K-12 Enrollment: 2010-11



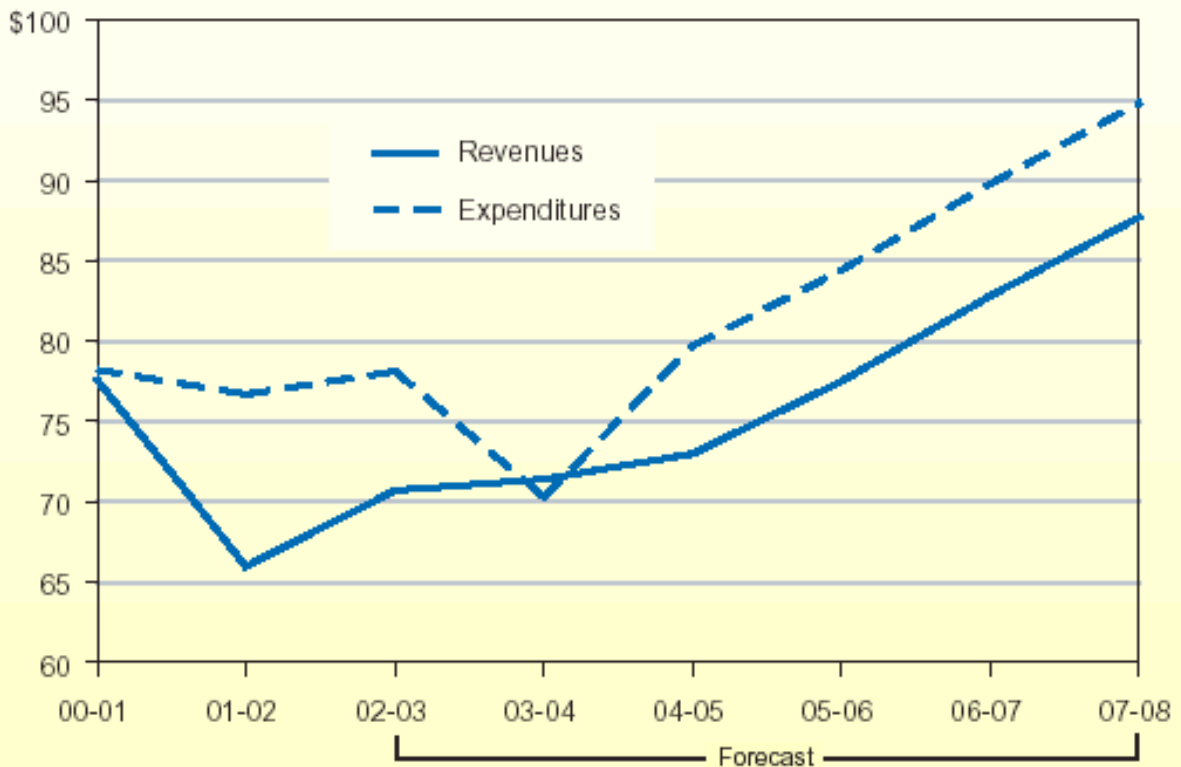


# Structural Deficit Estimated by LAO

Figure 7

**Persistent Gap Would Reemerge Under Governor's Plan**

General Fund  
(In Billions)

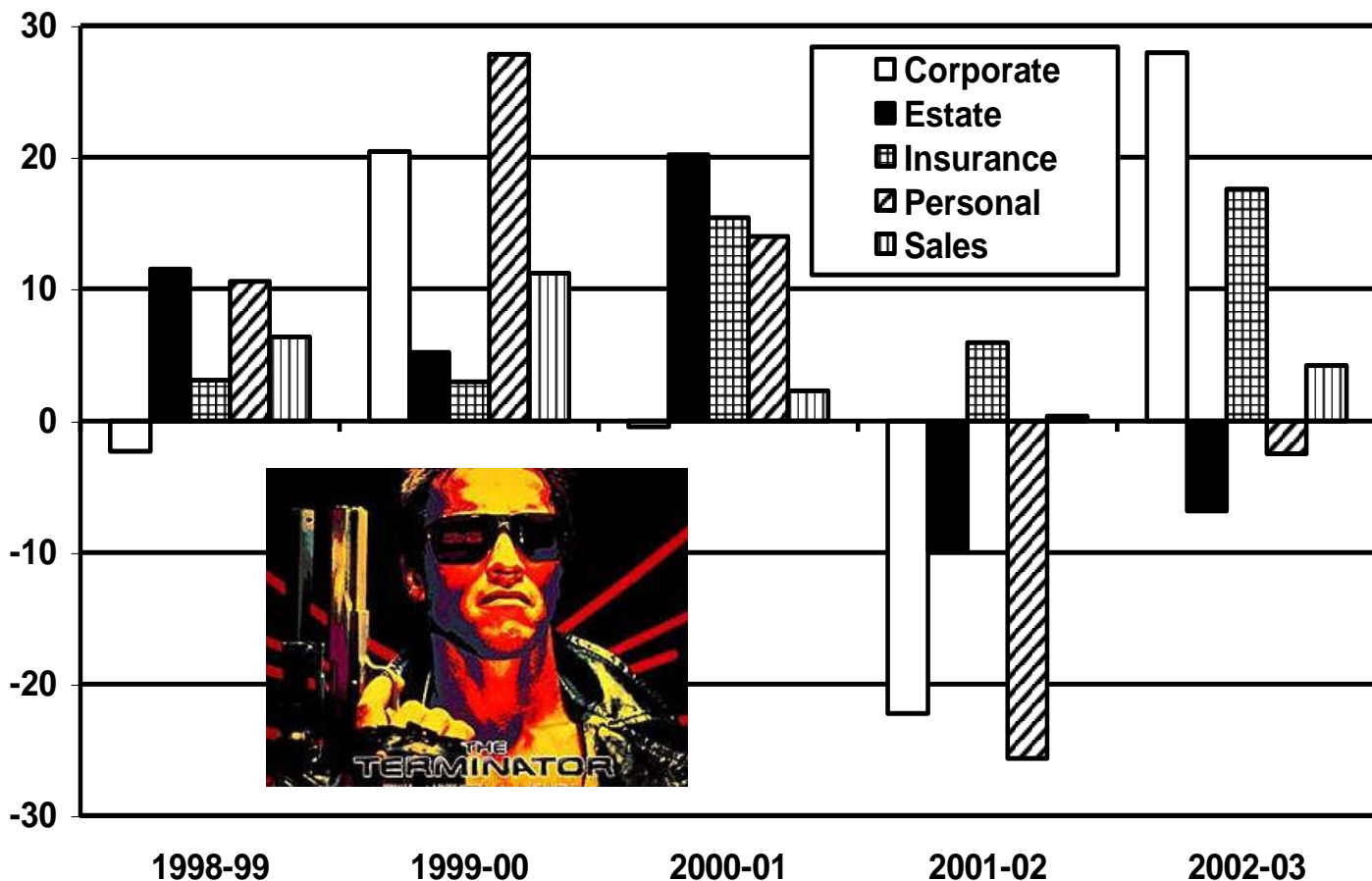


**Rand said same thing  
in mid-1990s!**

# *Some signs of bottoming out on revenue*

Annual Percent Change in Major General Fund Taxes

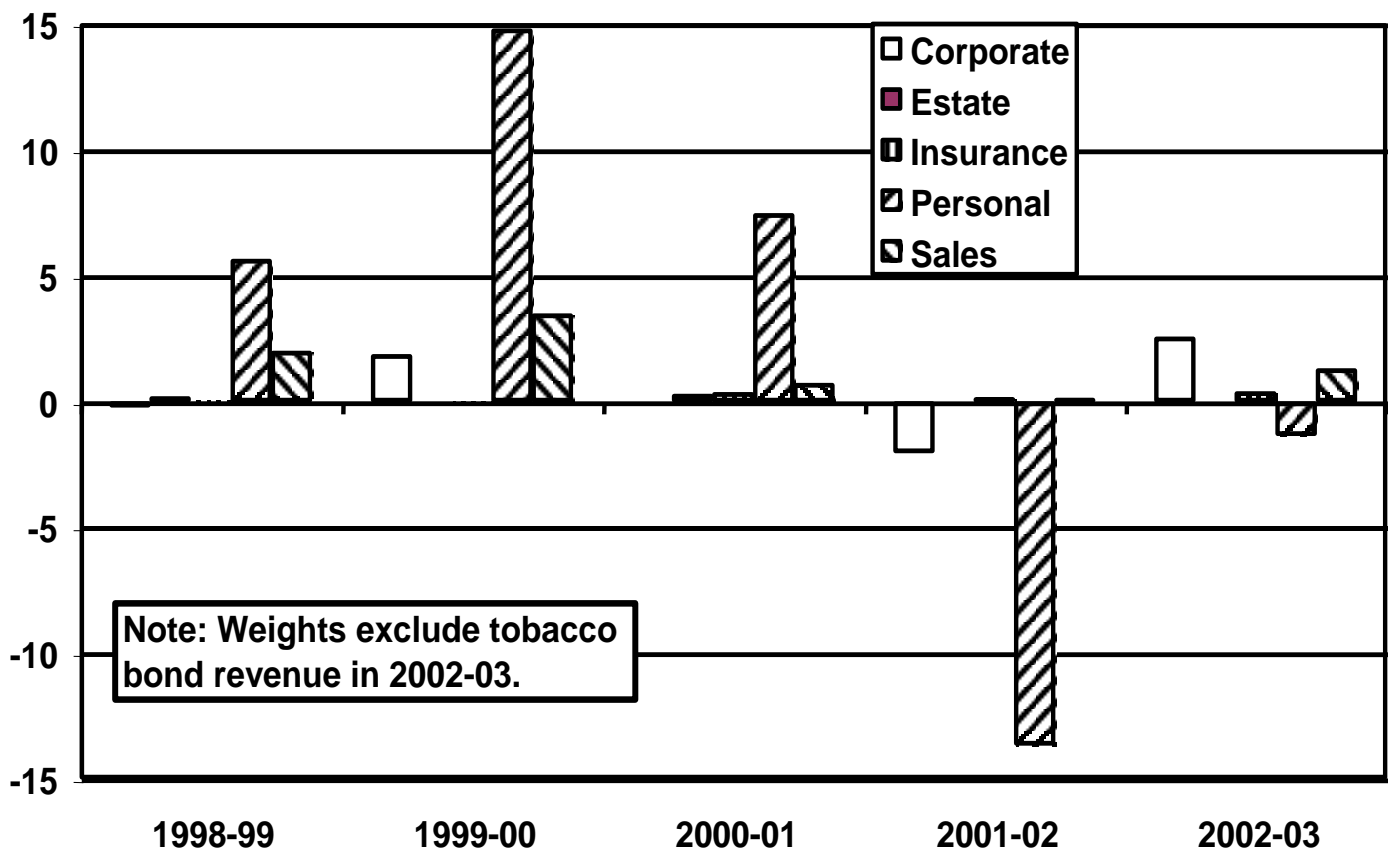
calborrow.xls  
Tax%ch



# *Some signs of bottoming out on revenue*

Annual Percent Change in Major General Fund Taxes  
Weighted by Revenue Share During 1998-99 - 2002-03

calborrow.xls  
Weight%



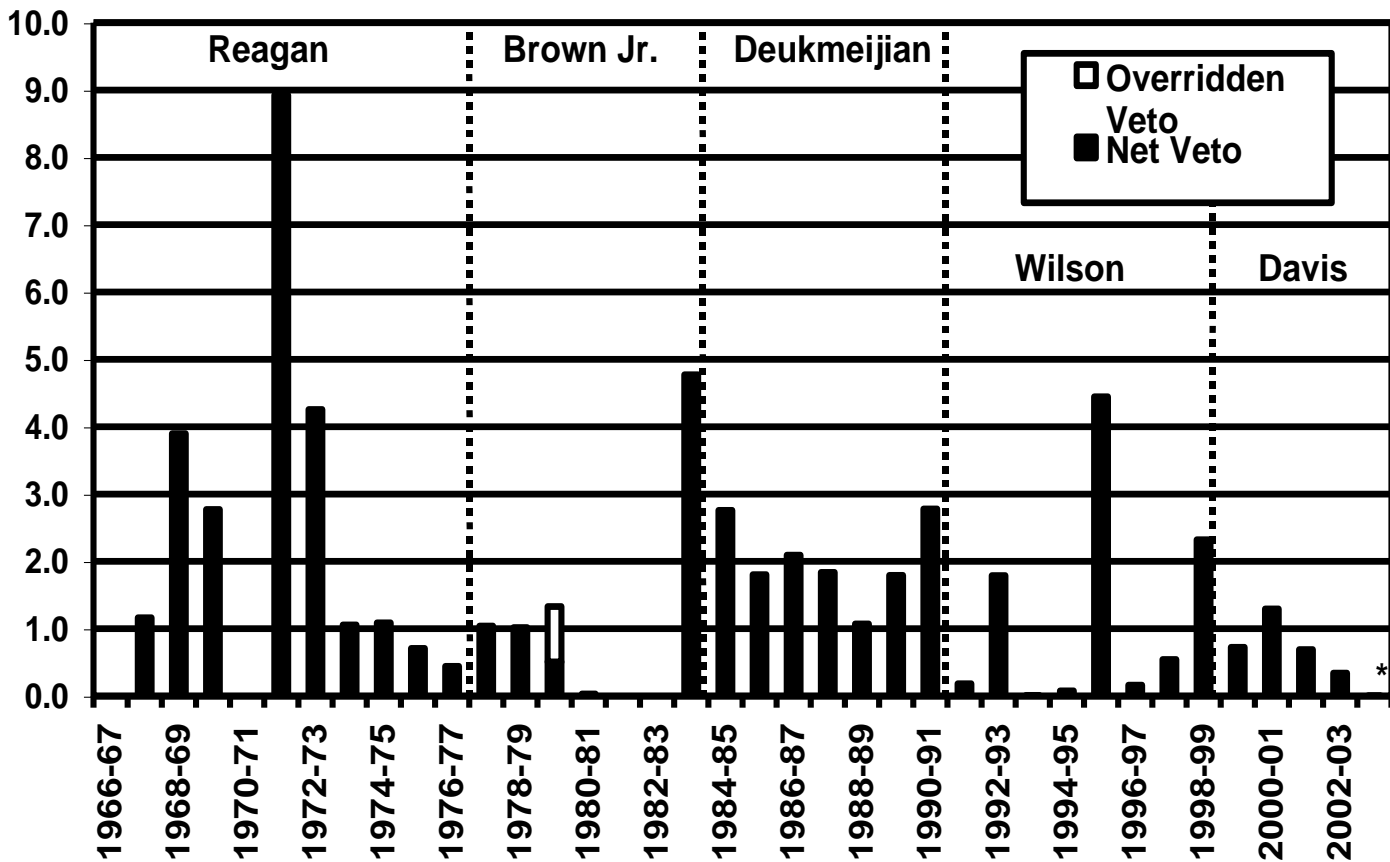
**But we need more oomph from  
personal income tax**



# And more oomph from the Governor?

General Fund Vetoes as Percent of Revenues and Transfers

CPObudget2004.xls  
VETO2



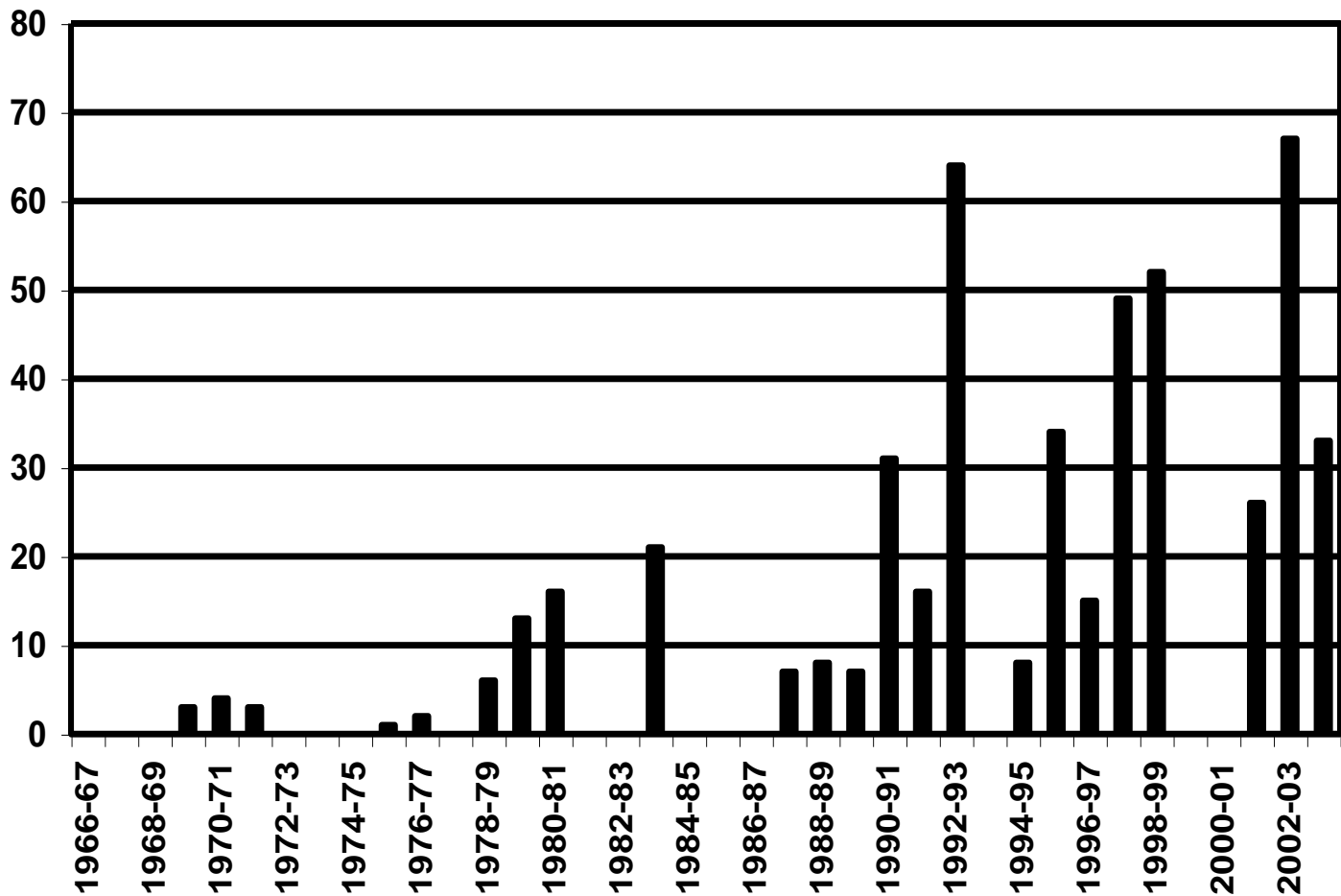
\*Veto of \$1 million in 2003-04.



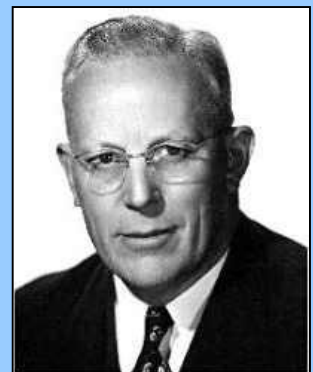
# Legislative Gridlock?

Days of Budget Delay Beyond June 30

CPObudget2004.xls  
DELAY2



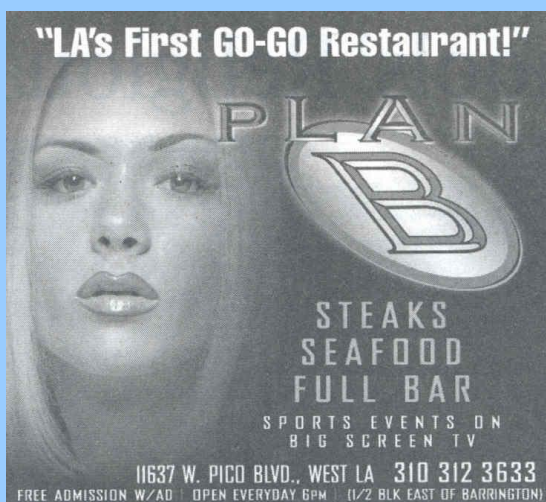
OR

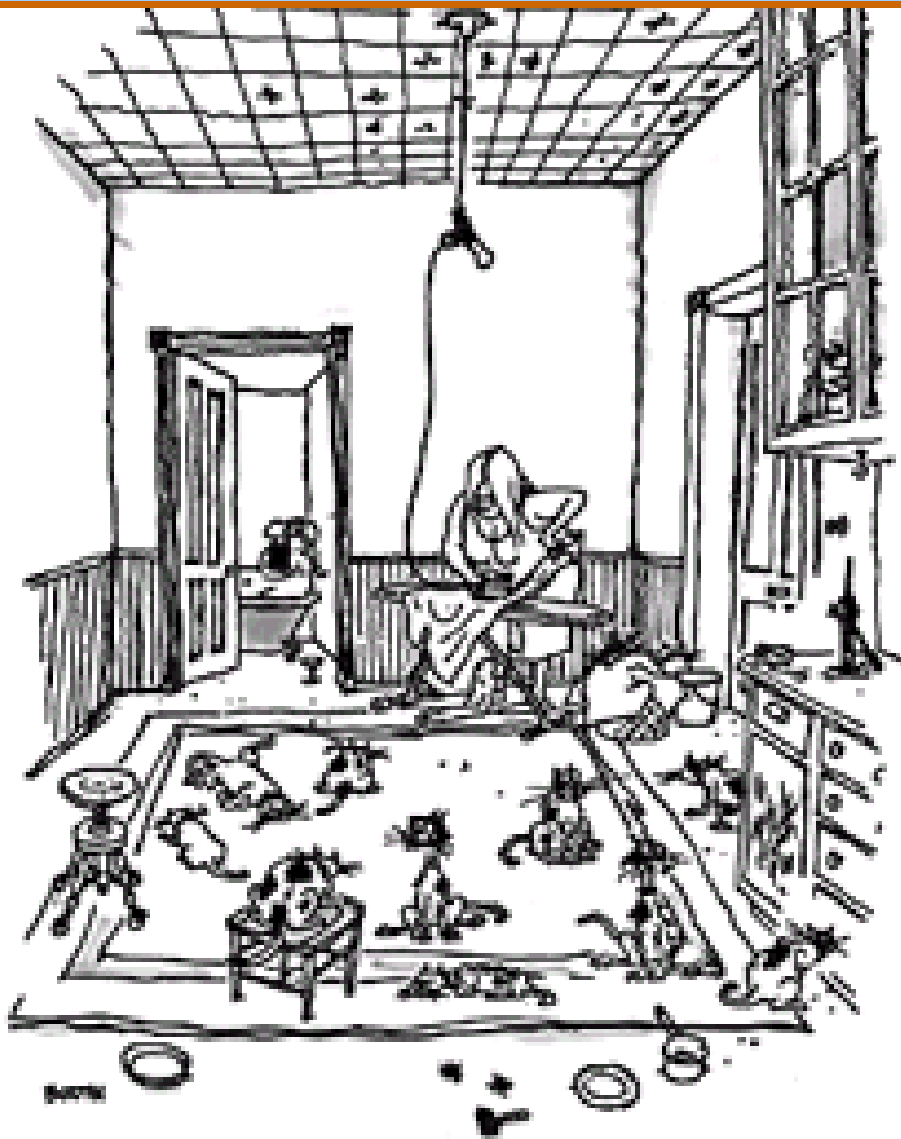






- **Absent responsible fiscal policy, funds for infrastructure, education, etc., will not be available for economic growth**
- **Need for transparency and user-friendliness**
- **Inconsistent accounting can undermine public trust**
- **Need to build up adequate reserves in Good Times**
- **Plan B**





***“I’m working on Plan B.”***

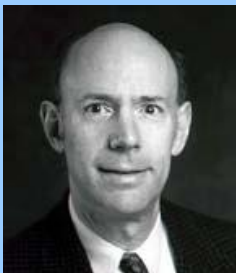
# ***Other proposed changes to current institutions***

- **$2/3 \implies 55\%$  vote in  
Legislature on budgets/taxes**
- **Penalties for legislative  
tardiness**
- **Relaxing term limits**
- **Mandated balanced budget  
or spending cap**



# *A modest proposal*

**If there is no budget enacted by July 1, the “May Revise” is the budget.**



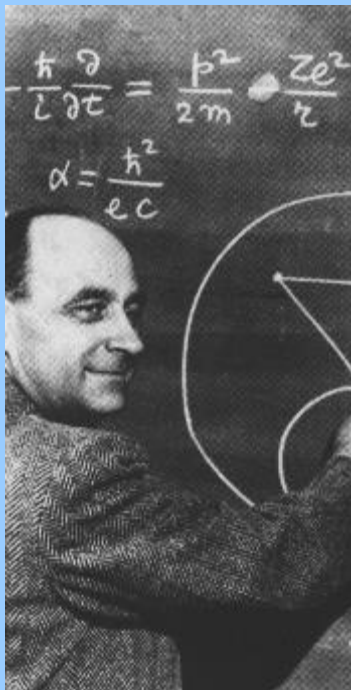
*A thought worth  
exploring?*

**Are there modern  
financial instruments that  
could help the state with  
market fluctuations?**



**“Before I came here, I was confused about this subject. Now I am still confused, but at a higher level.”**

***Enrico Fermi***





# **Family Time, Cliffs, and Train Wrecks:**

## *Recalling California's State Budget*



**Daniel J.B. Mitchell**

*Global Association of Risk Professionals*

*Oct. 29, 2003*